

**ANNUAL  
REPORT  
2016-2017**



**DEPARTMENT OF TAXATION  
STATE OF HAWAII**

# DEPARTMENT OF TAXATION

## VISION

*"The Department of Taxation will efficiently and effectively collect the revenue for funding programs and services for the people of Hawaii."*

## MISSION

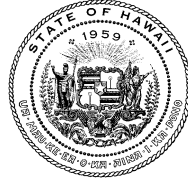
*"Our mission is to administer the tax laws for the State of Hawaii in a consistent, fair and uniform manner."*

## GOALS

1. To *"Increase Voluntary Compliance"* by
  - a. Increasing oversight utilizing various branches/areas of our Compliance Division
  - b. Developing procedures to ensure a more efficient and timely audit process
2. To *"Reduce Tax Fraud,"* through
  - a. Identification and preventing payment of fraudulent funds
3. To *"Improve customer service to all stakeholders"* by
  - a. Providing services to taxpayers whose issues/concerns cannot be resolved through normal channels
  - b. Providing specialized service to the tax practitioner community
4. To *"Improve technology and efficiencies through the successful implementation of the Tax System Modernization (TSM) project during this period"*
  - a. Complete Rollout 4 of the TSM project
  - b. Re-engineer business processes
5. *"Actively address tax receivable balances"* by
  - a. Collaboration with the Attorney General's office
  - b. Utilization of third parties to improve collections
6. To *"Foster and empower staff"* by
  - a. Developing each employee to his/her full potential

**DAVID Y. IGE**  
GOVERNOR

**SHAN TSUTSUI**  
LT. GOVERNOR



**MARIA E. ZIELINSKI**  
DIRECTOR OF TAXATION

**DAMIEN A. ELEFANTE**  
DEPUTY DIRECTOR

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**DEPARTMENT OF TAXATION**  
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December 6, 2017

The Honorable David Y. Ige  
Governor, State of Hawaii  
Executive Chambers, State Capitol

Dear Governor Ige:

Thank you for the opportunity to present you with the attached Annual Report summarizing the operations of the Department of Taxation (Department) for the fiscal year (FY) ending June 30, 2017. The Department collected \$6.94 billion in tax revenue in FY2017, or 95% of the \$7.34 billion that was collected from all taxes administered by the State. The General Excise Tax (GET) is Hawaii's largest source of revenue and accounted for 44% of the State's total tax collections in FY2017. Revenue from the GET rose to \$3.24 billion in FY2017 from \$3.21 billion in FY2016, an increase of 1.0%. Revenue from Hawaii's Individual Income Tax (IIT), Hawaii's second largest tax, increased to \$2.19 billion in FY2017, up by 3.6% from \$2.12 billion in FY2016. The IIT accounted for 30% of the State's total tax collections in FY2017.

During FY2017, the Department continued with the Tax System Modernization (TSM) project. The TSM project is a multi-year project with five rollout phases that will completely replace the existing system. The project will expand electronic services, providing taxpayers with online access to accounts and enabling full electronic filing and payment. The project will also automate the licensing, tax clearance, and compliance processes. Additionally, TSM will provide the State with critical data capture capabilities, metrics, and cross-check controls that are not available in the existing legacy system. The Department has been able to increase taxpayer compliance utilizing TSM tools to identify non-filers, industry segment comparisons, and identity theft to name a few. Likewise, TSM increased data availability which in turn improved the analytical capabilities of the Department's research branch. With the adoption of online tax filing, which can be done at no-cost, the Department expects to see an increase in electronic filing in future years.

During FY2017, the Department completed Rollout 2 and prepared for Rollout 3. The Department completed Rollout 2 on time as of August 15, 2016 which covered the general excise & use tax, seller's collection, country surcharge, and rental motor vehicle tax types, which covers over 40% of State revenue collections. On August 15, 2017, the Department successfully executed Rollout 3 for tax types: corporate income, franchise, public service company, and withholding. The Department remains on schedule to complete the entire project by mid-2019.

The Department continues to achieve its goals with a small operating budget. In FY2017, the

Department's operating expenses were \$24.3 million down from \$25.5 million in FY2009. The Department collected \$6.94 billion in taxes; the cost of collecting each \$100 dollars of taxes was only roughly 35 cents.

In FY 2017, Hawaii Tax Online (HTO), the Department's web portal for payments and filing of tax returns, was launched. More than 45% of general excise and transient accommodation taxpayers registered and used the web portal. While the Department has encouraged taxpayers to use electronic transmission rather than paper return, it processed over 1 million paper checks and over 2 million paper tax returns and other documents this fiscal year.

The Department continues to improve service to taxpayers and tax practitioners. This is important for maintaining and improving voluntary compliance. The total number of calls answered increased from 287,616 in FY2017 up from 275,924 in FY 2016.

The Department aggressively recruited to fill vacancies in other areas as well. While the Department's total vacancy rate for permanent positions increased 12.9% or 8 position due to retirements, internal promotions, and resignations, vacancies in the staff offices decreased by 38.5%.

The Compliance Division continued to make significant assessments worth \$146 million in FY 2017. The total number of completed audit cases increased by 5.1% % from 17,065 cases in FY2016 to 17,936 cases in FY2017. The amount collected from assessments decreased from \$39.9 million in FY2015 to \$37.0 million in FY2016.

The Department continues to pursue its goals of increased voluntary compliance, improved processing, enhanced productivity, and improved customer service for all of our stakeholders. We are proud and appreciative of all that our staff has accomplished during the past year. Empowered with new tools and technological enhancements, our Department has increased the efficiency and effectiveness of revenue collection that pay for the public services that the citizens of Hawaii enjoy.

Sincerely,

/s/

MARIA E. ZIELINSKI  
Director of Taxation

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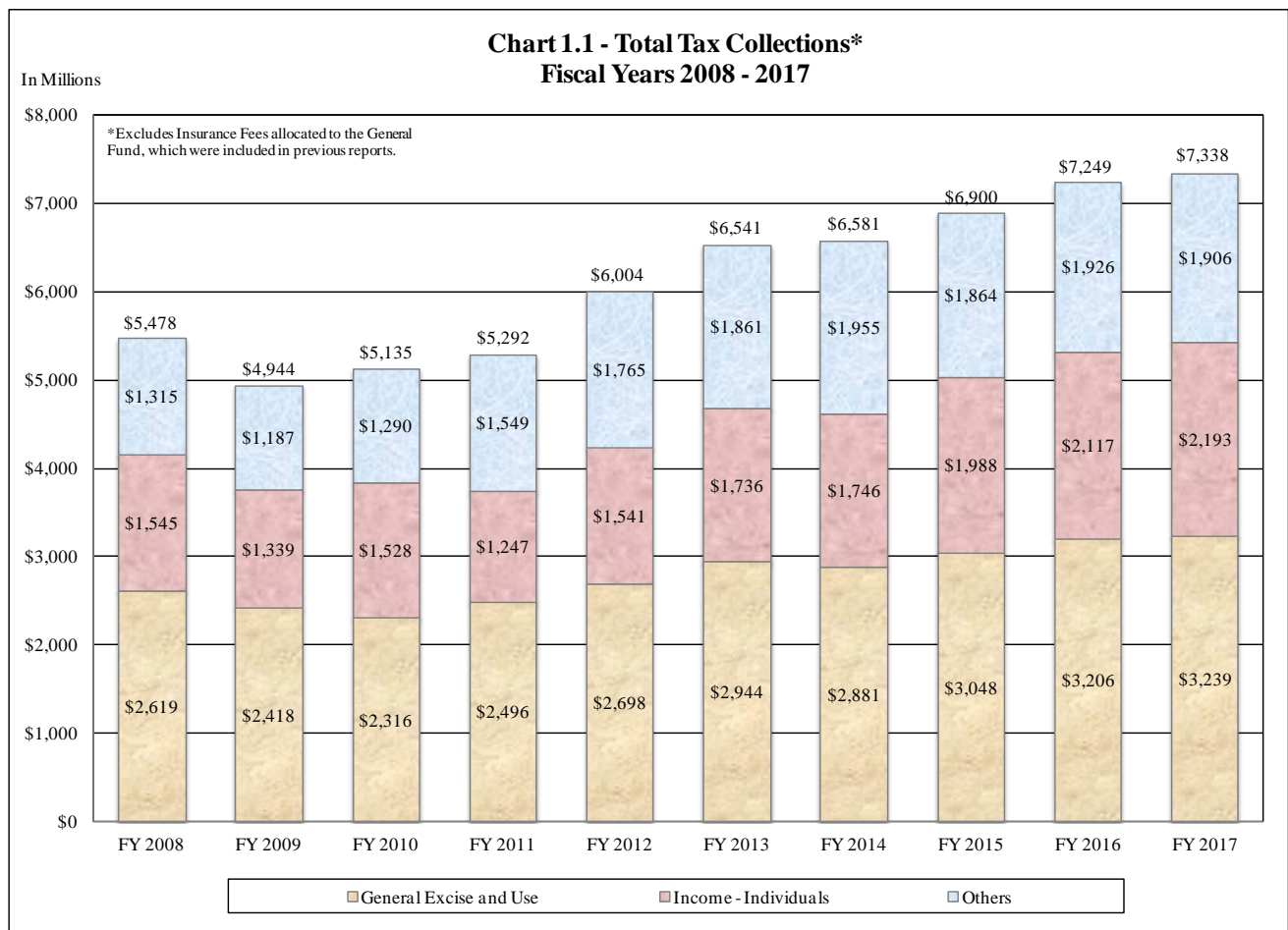
## 1.0 COLLECTION AND DISTRIBUTION OF TAXES

### 1.1 OVERVIEW

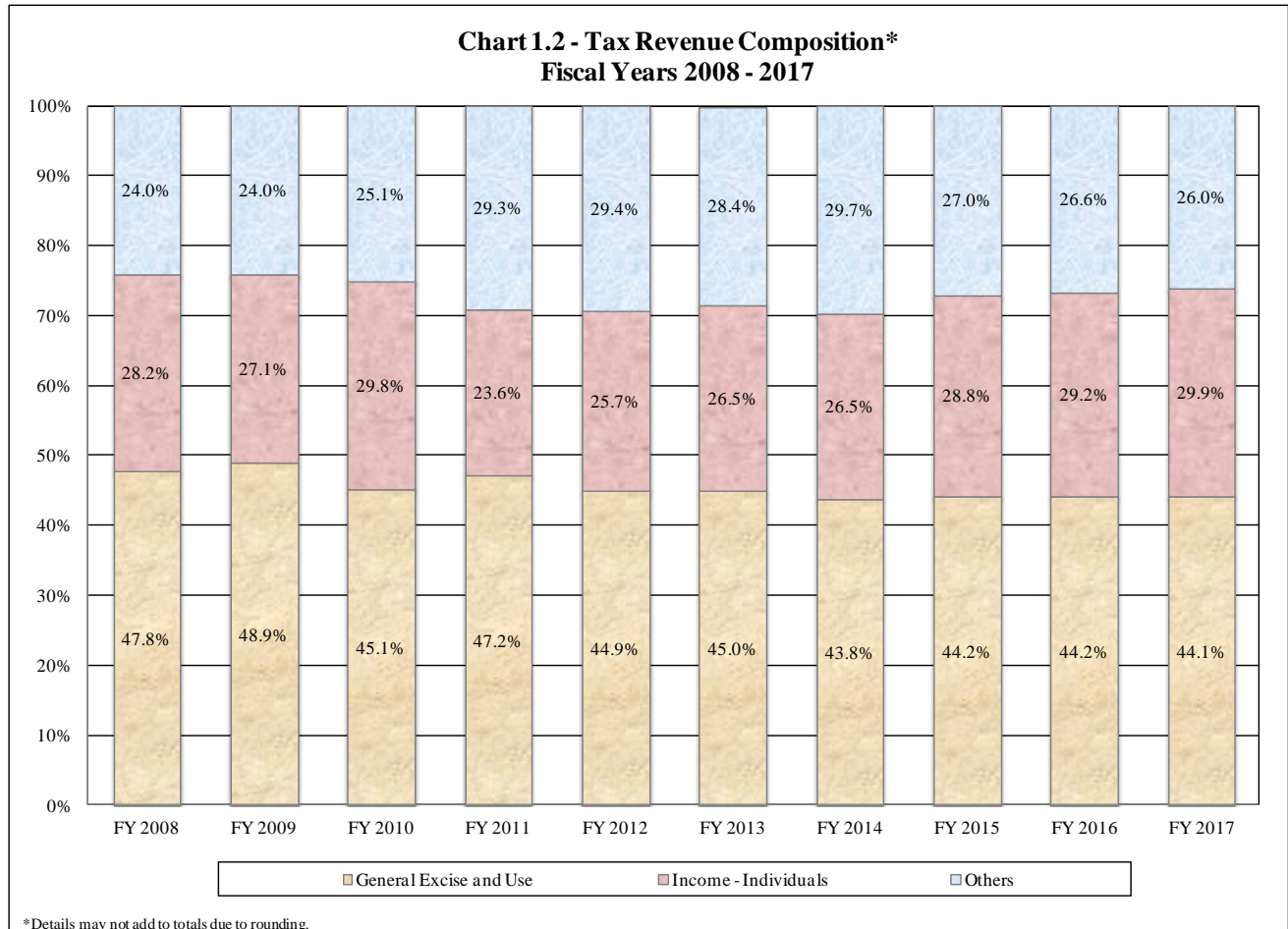
The Department of Taxation (Department) collects the revenues from the large majority of taxes imposed by the State. In addition, the Department collects the county surcharge imposed by the City and County of Honolulu and fuel taxes imposed by the counties. In fiscal year (FY) 2017, the Department collected a total of \$6.94 billion in net tax revenues, up from \$6.89 billion collected in FY 2016.

The Department's Office of Tax Research and Planning (TRP) tracks revenues from taxes collected by the Department as well as other taxes that are administered by the State but which are collected by other State agencies or the counties. Henceforth, revenues from the taxes tracked by TRP will be referred to as "total tax collections."

Total tax collections were \$7.34 billion in FY 2017, up from \$7.25 billion in FY 2016. In FY 2009, Hawaii experienced a decline in total tax collections as the Great Recession reduced incomes and spending of consumers and businesses. Since then, total tax collections have risen steadily due to temporary tax measures, an improving economy, and better tax administration. Chart 1.1 shows the main components of the total tax collections for FY 2008 through FY 2017.



The State's biggest sources of tax revenue are the general excise tax (GET)<sup>1</sup> and the individual income tax (IIT). In FY 2017, net GET collections amounted to \$3.24 billion and accounted for 44.1% of total tax collections, and net collections of the IIT amounted to \$2.19 billion and accounted for 29.9% of total tax collections. Chart 1.2 shows the shares of total tax collections accounted for by the GET and the IIT for FY 2008 through FY 2017.

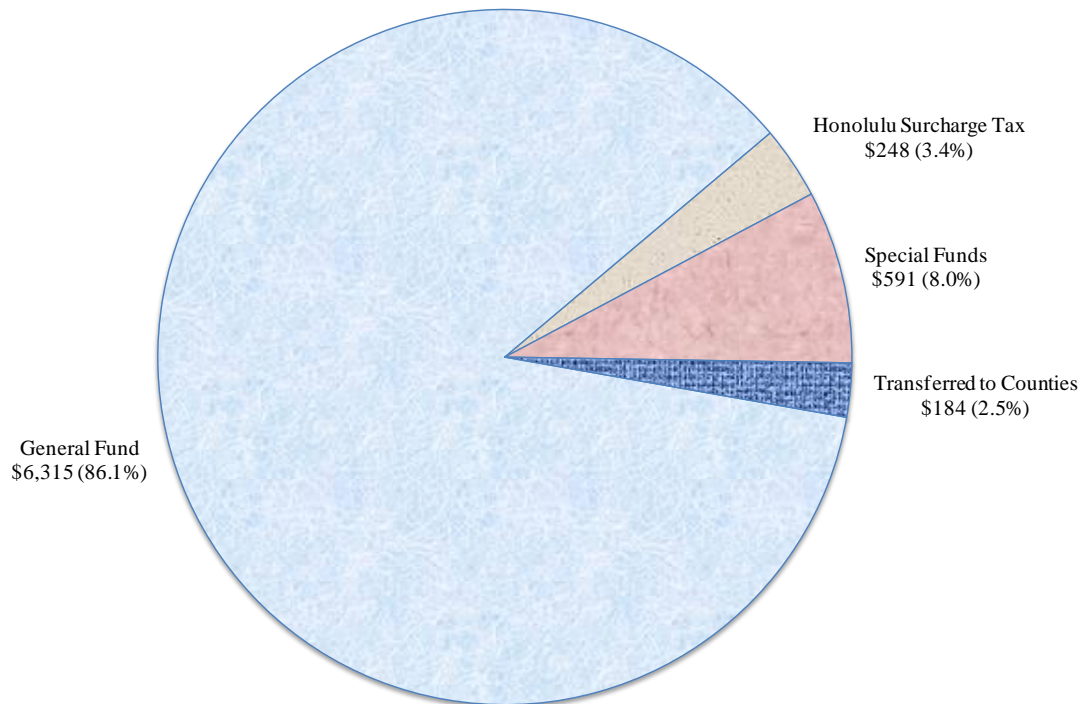


Of the total tax collections in FY 2017, \$6.32 billion, or 86.1%, was deposited into the State's General Fund. The tax revenues deposited into the General Fund are used to pay most of the State's operating expenses. An additional \$432.4 million, or 5.9% of the total tax collections, was transferred to the counties, including transfers of the county surcharge imposed by the City and County of Honolulu, fuel taxes imposed by the counties, and revenues from the transient accommodations tax that were allocated to the counties. The remaining \$590.7 million, or 8.0%, was transferred to various other State special funds. Chart 1.3 shows how the total tax collections were distributed in FY 2017.

<sup>1</sup> Throughout this report, the term "GET" will be used to include both the general excise tax and the use tax. The use tax complements the general excise tax and is levied on imports into the State from an unlicensed seller.



**Chart 1.3 - Fiscal Year 2017 Distribution of Tax Revenues\***  
(In millions of dollars)



\*Details may not add to totals due to rounding.

## 1.2 GENERAL EXCISE AND USE TAXES

### 1.2.1 Overview

Unlike the sales taxes imposed by many States and localities, Hawaii's general excise and use taxes (GET) are imposed on the business rather than on the customer. The GET covers virtually all forms of business activity, including services. Despite the relatively low tax rates, the GET generates substantial revenue because the tax base is very broad.

The GET is imposed at the rate of 0.50% on wholesaling, wholesale services, producing and manufacturing; at the rate of 0.15% on insurance commissions received by general agents, subagents and solicitors; and at the rate of 4.00% on most other activities, including retailing, business and professional services, contracting, theatre, amusement, radio, interest, commissions, and rentals. The fee for a GET license is a one-time charge of \$20.

### 1.2.2 Revenue

Revenue from the GET rose from \$3.21 billion in FY 2016 to \$3.24 billion in FY 2017, a rise of 1.0%. Chart 1.4 shows the total revenues from the GET and from the tax levied on the various categories of income for FY 2008 through FY 2017. Table 1.1 shows collection of the GET in greater detail for FY 2016 and FY 2017.

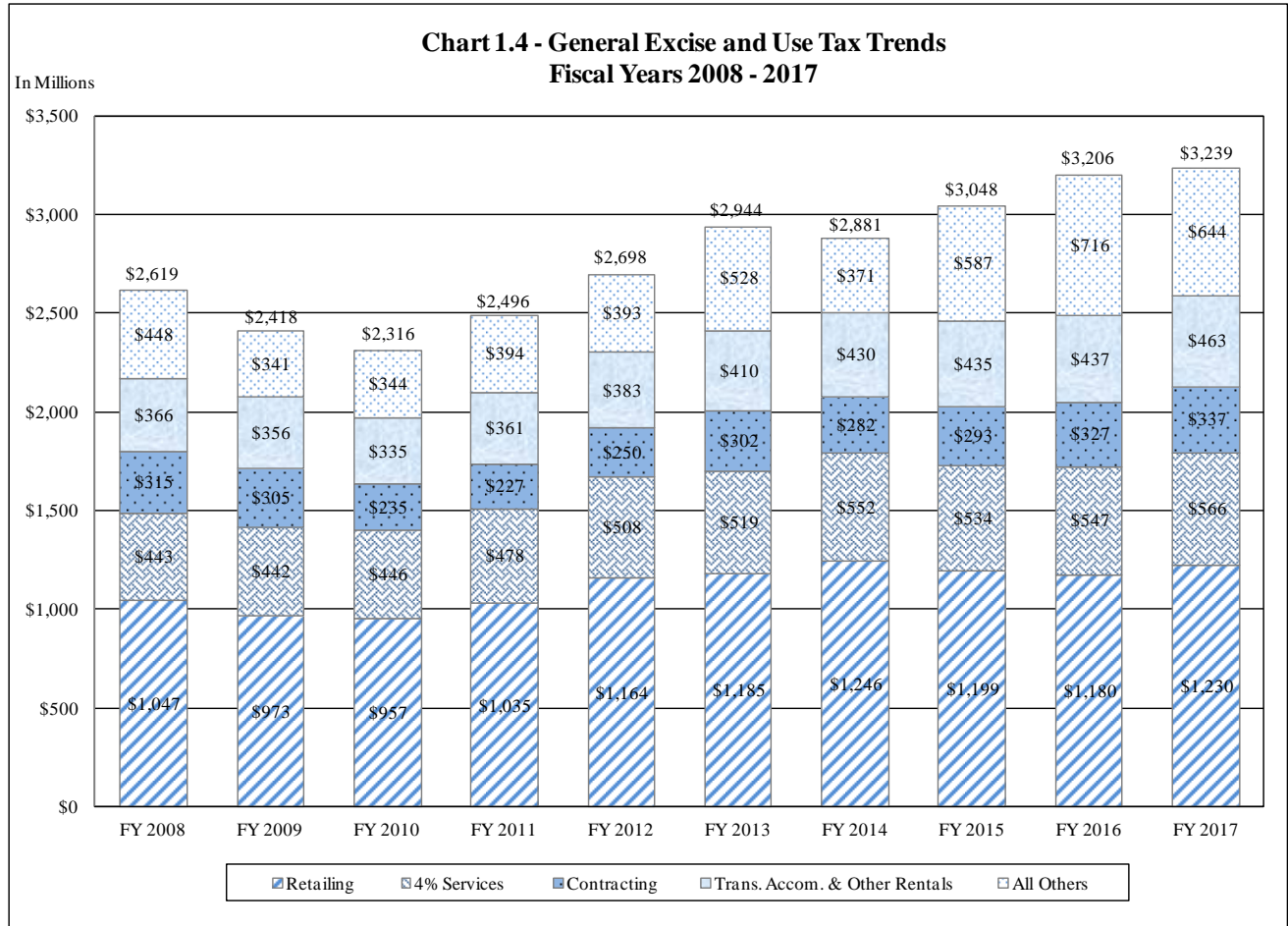


TABLE 1.1 - GENERAL EXCISE AND USE TAX BASE AND TAXES  
FOR FISCAL YEARS ENDING JUNE 30, 2017 AND 2016  
(In Thousands of Dollars)

SOURCE OF REVENUE	Rate	FY 2017	FY 2016	Difference	
				Amount	% Change
<u>TAX BASE</u>					
Retailing		\$ 30,746,503	\$ 29,497,784	\$ 1,248,719	4.2
Services		14,161,644	13,667,109	494,535	3.6
Contracting		8,417,926	8,184,839	233,087	2.8
Trans. Accom. Rentals		4,897,966	4,441,787	456,179	10.3
All Other Rentals		6,668,941	6,474,425	194,516	3.0
All Others (4%)		<u>5,918,583</u>	<u>5,406,921</u>	<u>511,663</u>	<u>9.5</u>
Subtotal		\$ 70,811,563	\$ 67,672,864	\$ 3,138,699	4.6
Producing		\$ 323,829	\$ 294,609	\$ 29,221	9.9
Manufacturing		731,315	733,992	(2,676)	(0.4)
Wholesaling		14,461,903	13,864,351	597,552	4.3
Use (1/2%)		6,799,232	7,354,311	(555,079)	(7.5)
Wholesale Services		870,497	707,822	162,674	23.0
Insurance Commissions		<u>495,059</u>	<u>485,363</u>	<u>9,696</u>	<u>2.0</u>
Subtotal		\$ 23,681,836	\$ 23,440,448	\$ 241,387	1.0
TOTAL - ALL ACTIVITIES		<u>\$ 94,493,398</u>	<u>\$ 91,113,312</u>	<u>\$ 3,380,086</u>	<u>3.7</u>
<u>TAX</u>					
Retailing	4.00%	\$ 1,229,860	\$ 1,179,911	\$ 49,949	4.2
Services	4.00%	566,466	546,684	19,781	3.6
Contracting	4.00%	336,717	327,394	9,323	2.8
Trans. Accom. Rentals	4.00%	195,919	177,671	18,247	10.3
All Other Rentals	4.00%	266,758	258,977	7,781	3.0
All Others (4%)	4.00%	<u>236,743</u>	<u>216,277</u>	<u>20,467</u>	<u>9.5</u>
Subtotal		\$ 2,832,463	\$ 2,706,915	\$ 125,548	4.6
Producing	0.50%	\$ 1,619	\$ 1,473	\$ 146	9.9
Manufacturing	0.50%	3,657	3,670	(13)	(0.4)
Wholesaling	0.50%	72,310	69,322	2,988	4.3
Use (1/2%)	0.50%	33,996	36,772	(2,775)	(7.5)
Wholesale Services	0.50%	4,352	3,539	813	23.0
Insurance Commissions	0.15%	<u>743</u>	<u>728</u>	<u>15</u>	<u>2.0</u>
Subtotal		\$ 116,676	\$ 115,503	\$ 1,173	1.0
Unallocated*		<u>\$ 290,086</u>	<u>\$ 383,736</u>	<u>\$ (93,649)</u>	<u>(24.4)</u>
TOTAL - ALL ACTIVITIES		<u>\$ 3,239,225</u>	<u>\$ 3,206,154</u>	<u>\$ 33,072</u>	<u>1.0</u>

\*Includes collections from penalty and interest, assessments and corrections, delinquent collections, refunds, protested payments, settlements and business activities of disabled persons.

NOTE: Details may not add to totals due to rounding.

### ***1.2.3 Recent Legislation***

Act 54, SLH 2017, adds a new category of affordable housing projects that qualifies for the GET exemption. The exemption for the new category is limited to contractors. The Act also limits the total amount of the exemption to \$7 million per year. The Act applies to taxable years beginning after December 31, 2017, and ending before July 1, 2022.

## **1.3 INDIVIDUAL INCOME TAX**

### ***1.3.1 Overview***

Hawaii's individual income tax (IIT) generally follows the federal definitions for determining net taxable income, but has its own exemptions, tax credits, and tax rates. In FY 2017, IIT had nine brackets, with tax rates ranging from 1.40% to 8.25%.

### ***1.3.2 Revenue***

The IIT is the State's second largest source of tax revenue. The biggest part of IIT collections is taxes withheld on employee wages. In FY 2017, withholding tax collections were \$1.92 billion, an increase of 5.9 % over the \$1.81 billion withheld in FY 2016. Total IIT refunds in FY 2017 were \$467.7 million, up from \$450.7 million in FY 2016. Net IIT collections in FY 2017 were \$2.19 billion, up by 3.6% over the \$2.12 billion collected in FY 2016. Chart 1.5 shows total collections of the IIT, along with wage withholding, payments with returns, estimated taxes, and refunds, for FY 2008 through FY 2017. Table 1.2 shows the figures for total collections of the IIT, broken down by its components, in FY 2016 and FY 2017.

### ***1.3.3 Recent Legislation***

Act 120, SLH 2015, provided a tax credit for converting cesspools to a septic system, or for connecting to a wastewater system, from July 1, 2015 to December 31, 2020.

Act 223, SLH 2015 (Act 223), increased the food/excise tax credit, but eliminated the tax credit for single taxpayers with federal adjusted gross income (AGI) of \$30,000 or more, or other taxpayers with federal AGI of \$50,000 or more. The Act applies to tax years 2016 and 2017, and is repealed on December 31, 2017.

Act 230, SLH 2016 (Act 230), allows taxpayers engaged in medical marijuana businesses to deduct business expenses and claim tax credits on their income taxes. Act 230 is effective for taxable years beginning after December 31, 2015.

Act 235, SLH 2016 (Act 235), amends the income tax credit for dependent care expenses by increasing the amount that certain taxpayers may claim for the dependent care expenses. Act 235 is effective for taxable years beginning after December 31, 2015.

Act 258, SLH 2016, provides a new tax credit for organic food production. The tax credit applies to taxable years beginning after December 31, 2016 and is repealed December 31, 2021.

Act 7, SLH 2017, makes the filing frequency for withholding tax quarterly for all taxpayers, effective January 1, 2018. However, the Act does not affect the frequency of withholding tax payments.

Act 107, SLH 2017, reinstates the three top tax brackets (with rates of 9%, 10%, and 11%) for high-income taxpayers that had previously been imposed temporarily by Act 60, SLH 2009. The new top tax brackets take effect for taxable years beginning after December 31, 2017. The Act repeals the sunset date (December 31, 2017) for the amendments made to the food/excise tax credit by Act 223. The Act also establishes a state nonrefundable earned income tax credit (EITC) equal to 20 percent of the federal EITC. The tax credit applies to tax years 2018 through 2022.

Act 125, SLH 2017, broadens the eligibility criteria for the cesspool tax credit, and is effective on July 1, 2017.

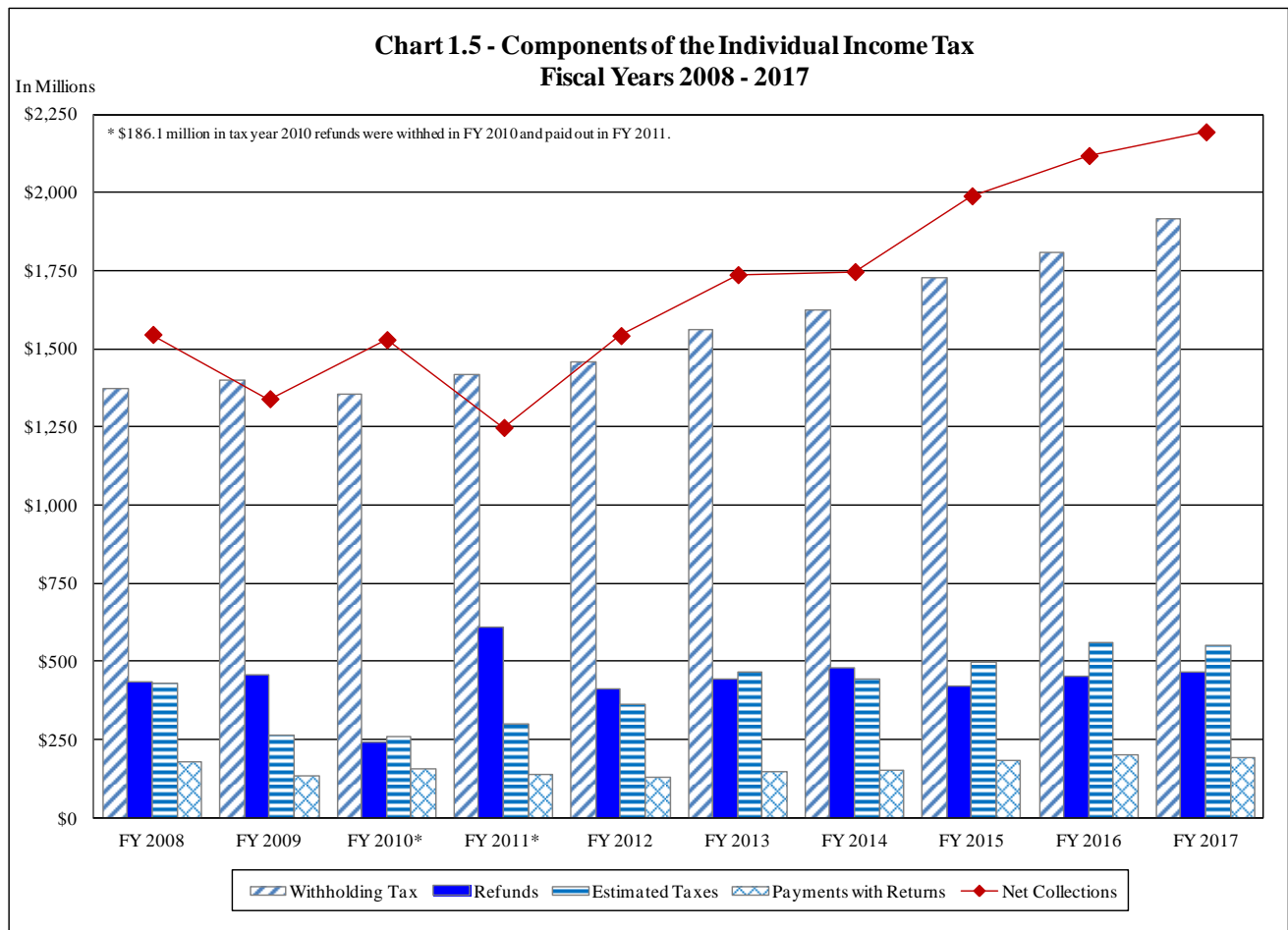


TABLE 1.2 - TAXES PAID BY INDIVIDUALS  
(In Thousands of Dollars)

	FY 2017	FY 2016	Difference	
			Amount	% Change
Declaration of Estimated Taxes	\$ 552,236	\$ 558,669	\$ (6,432)	(1.2)
Payment with Return	191,898	199,026	(7,128)	(3.6)
Withholding Tax on Wages	1,916,350	1,809,855	106,495	5.9
Subtotal	\$2,660,484	\$2,567,549	\$ 92,935	3.6
Refunds	467,681	450,690	16,991	3.8
NET	\$2,192,803	\$2,116,859	\$ 75,943	3.6

NOTE: Due to rounding, details may not add to totals.

## 1.4 CORPORATE INCOME TAX

### 1.4.1 Overview

Hawaii's corporate income tax (CIT) has three tax brackets. The brackets and the corresponding tax rates are as follows: 4.4% on taxable income up to \$25,000; 5.4% on taxable income over \$25,000 but not over \$100,000; and 6.4% on taxable income over \$100,000. The tax rate for corporate capital gains is 4.0%.

### 1.4.2 Revenue

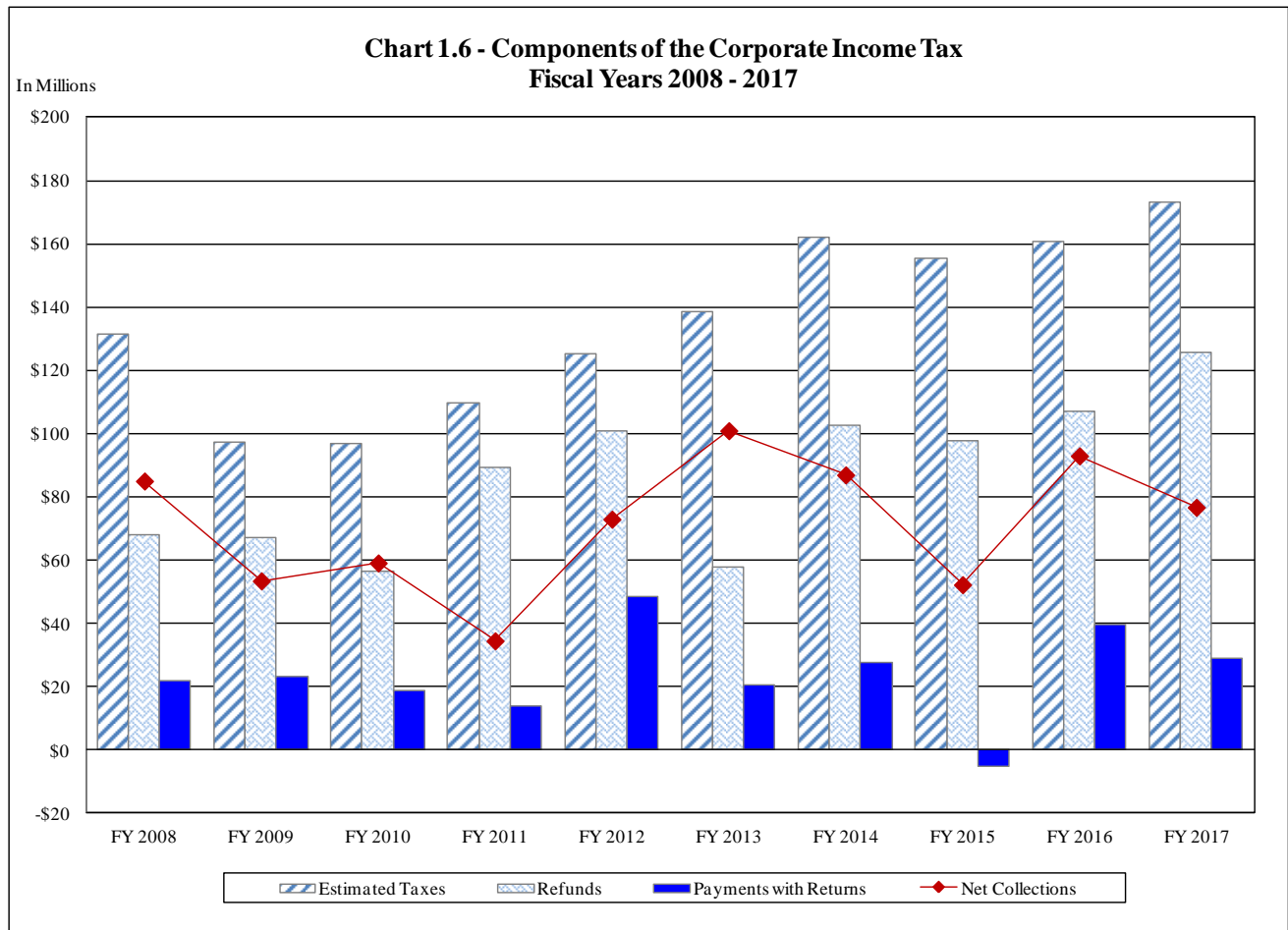
Net CIT collections totaled \$76.8 million in FY 2017, a decrease of 17.5% from the previous year's total of \$93.0 million. CIT collections are highly cyclical, but they are a relatively small part of Hawaii's total tax collections. In FY 2017, the CIT accounted for just 1.0% of total tax collections. Chart 1.6 shows total collections of the CIT, broken down by its components, for FY 2008 through FY 2017. Table 1.3 shows data on collections of the CIT for FY 2016 and FY 2017.

### 1.4.3 Recent Legislation

Act 142, SLH 2017, changes the certification process for the renewable fuels production tax credit. Taxpayers must file a third-party certified statement with the Department of Business, Economic Development, and Tourism (DBEDT) within 30 days of the close of the calendar year. DBEDT will then issue a certificate to taxpayers. The Act applies to taxable years beginning after December 31, 2017.

Act 143, SLH 2017, amends the film tax credit by imposing an aggregate cap of \$35 million per year, provided that any excess in claims above the cap can be applied in a subsequent year until December 31, 2025. The Act also extends the sunset date for the tax credit from January 1, 2019 to January 1, 2026. The Act is effective for taxable years beginning after December 31, 2018.

Act 213, SLH 2017, expands the categories of purchases that qualify for the capital infrastructure tax credit. The Act also increases the amount of the tax credit that can be claimed for costs incurred by any qualified infrastructure tenant during a tax year from \$1.25 million to \$2.50 million. The Act is effective on July 12, 2017.



**TABLE 1.3 - TAXES PAID BY CORPORATIONS**  
(In Thousands of Dollars)

	FY 2017	FY 2016	Difference	
			Amount	% Change
Declaration of Estimated Taxes	\$ 173,258	\$ 160,563	\$ 12,695	7.9
Payment with Return	29,212	39,459	(10,247)	(26.0)
Subtotal	\$ 202,470	\$ 200,022	\$ 2,448	1.2
Refunds	125,709	106,986	18,723	17.5
NET	\$ 76,761	\$ 93,036	\$ (16,275)	(17.5)

NOTE: Due to rounding, details may not add to totals.

## **1.5 TRANSIENT ACCOMMODATIONS TAX**

### ***1.5.1 Overview***

The transient accommodations tax (TAT) is levied on the furnishing of a room, apartment, suite, or the like, which is customarily occupied by the transient for less than 180 consecutive days. The rate for the TAT has been 9.25% since July 1, 2010. The registration fee for transient accommodations operators is a one-time fee of \$5 for each registration consisting of 1 to 5 units and \$15 for each registration of 6 or more units. In FY 2017, plan managers of time share units paid TAT at the rate of 8.25% on the fair market rental value of the units from July 1, 2016 through December 31, 2016 and at the rate of 9.25% from January 1, 2017 through June 30, 2017.

### ***1.5.2 Revenue***

TAT collections totaled \$508.4 million for FY 2017, an increase of 13.8% from the \$446.8 million collected in FY 2016. In FY 2017, collections from the TAT were distributed as follows: \$103.0 million went to the counties; \$26.5 million went to the Convention Center Enterprise Special Fund; \$82.0 million went to the Tourism Special Fund; \$1.5 million went to the Turtle Bay Conservation Easement Special Fund; \$3.0 million went to the Special Land and Development Fund; and the remainder (\$292.4 million) went to the General Fund. Chart 1.7 shows collections of the TAT for FY 2008 through FY 2017. Chart 1.8 shows the allocations of the tax among the various funds. Table 1.4 shows TAT collections and allocations in FY 2016 and FY 2017.

### ***1.5.3 Recent Legislation***

Act 93, SLH 2015, raised the tax on resort time share vacation units from 7.25% to 8.25% in calendar year (CY) 2016, and to 9.25% in CY 2017 and thereafter.

Act 117, SLH 2015, allocates \$3.0 million of the TAT annually to the Special Land and Development Fund, starting in FY 2017.

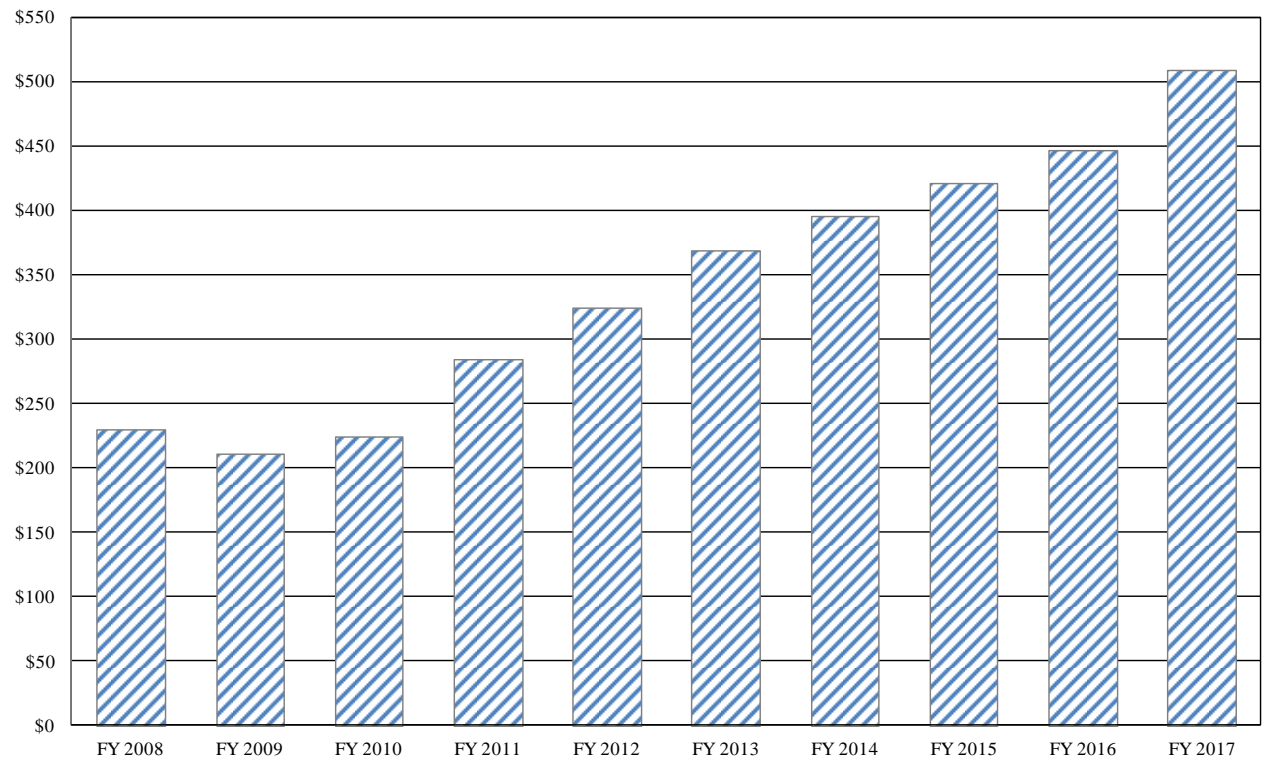
Act 121, SLH 2015, allocates \$1.5 million of the TAT to the Turtle Bay Conservation Easement Special Fund, replacing the \$3.0 million annual allocation made by Act 81, SLH 2014.

Act 223, SLH 2016, extends the TAT allocation of \$103.0 million to the counties to FY 2017.



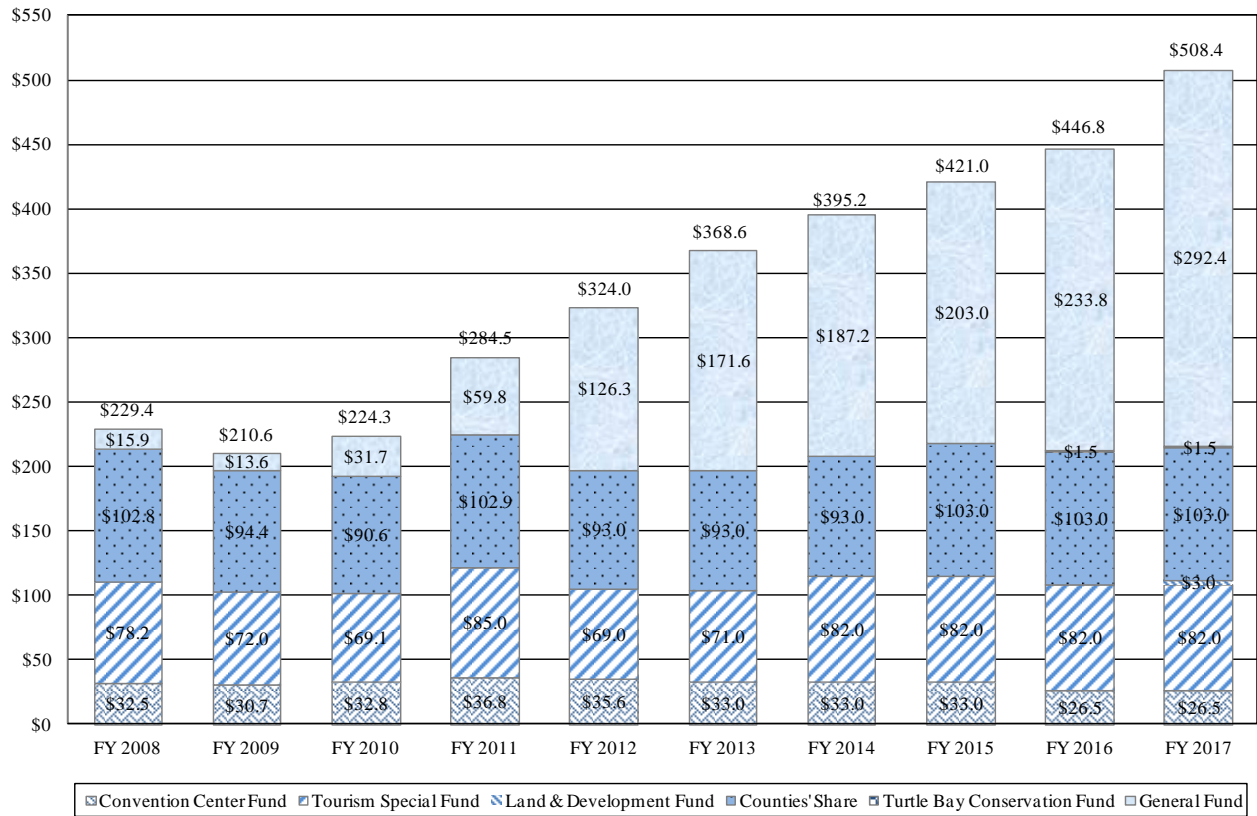
**Chart 1.7 - Transient Accommodations Tax  
Fiscal Years 2008 - 2017**

In Millions



**Chart 1.8 - Transient Accommodations Tax Distributions**  
**Fiscal Years 2008 - 2017**

In Millions



**TABLE 1.4 - TRANSIENT ACCOMMODATIONS TAX**  
(In Thousands of Dollars)

			Difference	
	FY 2017	FY 2016	Amount	% Change
Collection				
Trans. Accom./Time Share Occ. Tax	\$ 508,357	\$ 446,781	\$ 61,577	13.8
Trans. Accom./Time Share Occ. Fees	20	13	7	48.9
Total	\$ 508,377	\$ 446,794	\$ 61,583	13.8
Distribution*				
Counties Share	\$ 103,000	\$ 103,000	\$ -	-
Convention Center Fund	26,500	26,500	-	-
Tourism Special Fund	82,000	82,000	-	-
Turtle Bay Special Fund	1,500	1,500	-	-
Land & Development Fund	3,000	-	3,000	n/m
General Fund	292,377	233,794	58,583	25.1
Total	\$ 508,377	\$ 446,794	\$ 61,583	13.8

\*For details on distribution see section 237D-6.5, HRS.

NOTE: Due to rounding, details may not add to totals.

n/m = not meaningful.

## **1.6 FUEL TAXES**

### ***1.6.1 Overview***

The State and county fuel taxes are imposed on the distributors. The State Legislature sets the State fuel tax rates, whereas county councils set the county rates. There is also an environmental response tax (officially renamed as the "environmental response, energy and food security tax" by Act 73, SLH 2010) that is levied on each barrel of petroleum products and each million British thermal units (MMBtu) of non-petroleum fossil fuels sold by a distributor to any retail dealer or end user. The effective rates for the fuel taxes and for the environmental response tax are shown on page 15.

### ***1.6.2 Revenue***

Fuel tax collections (including the environmental response tax) amounted to \$194.8 million in FY 2017, a decrease of 1.7% from the \$198.1 million collected in FY 2016. Total taxable fuel consumption increased from 882.0 million gallons in FY 2016 to 887.4 million gallons in FY 2017. The biggest consumption of taxable fuel was gasoline (468.0 million gallons) and the second biggest consumption was aviation fuel (205.9 million gallons). Together, gasoline and aviation fuel accounted for 75.9% of the total consumption of taxable fuel in FY 2017.

Collections of the environmental response tax amounted to \$26.5 million in FY 2017, a decrease of 1.7% from the \$27.0 million collected in FY 2016. The environmental response tax rate on each barrel of petroleum product was \$1.05. The tax was levied on 24.2 million barrels of petroleum in FY 2017, down from 24.8 million barrels in FY 2016. The environmental response tax rate on each MMBtu of non-petroleum fossil fuels was nineteen cents. The tax was levied on 5.6 million MMBtu of non-petroleum fossil fuels in FY 2017, up from 4.8 million MMBtu in FY 2016. Chart 1.9 shows collections of the fuel taxes and the gallons consumed of the various fuel types, for FY 2008 through FY 2017. Data for taxable gallons consumed in FY 2016 and FY 2017 are given in Table 1.5.

The revenues from fuel taxes are distributed to several special funds. One percent of the fuel taxes paid on liquid fuel, not including aviation fuel, are deposited into the Boating Special Fund. Fuel taxes paid on sales of aviation fuel are deposited into the Airport Revenue Fund. Remaining revenues from the State fuel taxes are deposited into the State Highway Fund, whereas remaining revenues from county fuel taxes are deposited into the counties' highway funds.

Revenues from the environmental response tax were distributed as follows in FY 2017: For each barrel taxed at \$1.05, five cents went to the Environmental Response Revolving Fund administered by the Department of Health for oil spill prevention and remediation programs; fifteen cents went to the Energy Security Special Fund administered by the Department of Business, Economic Development, and Tourism to support the Hawaii clean energy initiative program; fifteen cents went to the Agricultural Development & Food Security Special Fund administered by the Department of Agriculture to fund activities intended to increase agricultural production or processing that may lead to reduced importation of food, fodder, or feed from outside the state; ten cents went to the Energy Systems Development Special Fund, and the remainder (sixty cents) went to the General Fund. For each MMBtu taxed at nineteen cents, one cent went to the Environmental Response Revolving Fund, three cents went to the Energy Security Special Fund, three cents went to the Agricultural Development & Food Security Special Fund, two cents went to the Energy Systems Development Special Fund, and the remainder (ten cents) went to the General Fund.

Table 1.6 shows how the fuel taxes and the environmental response tax were allocated in FY 2016 and FY 2017. The table also shows allocations of the motor vehicle taxes and fees to the State Highway Fund.

### ***1.6.3 Recent Legislation***

Act 107, SLH 2014, reestablished the Energy Systems Development Special Fund and extended the \$1.05 per barrel rate for the environmental response tax through fiscal year 2030. (The tax rate was scheduled to go back to \$0.05 per barrel at the end of fiscal year 2015.)

Act 185, SLH 2015, applies the environmental response tax to non-petroleum fossil fuels at nineteen cents per million British thermal units effective July 1, 2015, and removes the sunsets to various funds related to the tax.

SCHEDULE OF FUEL TAX RATES PER GALLON <sup>4</sup>  
(Effective July 1, 2016)

TYPE OF FUEL	STATE TAX	COUNTY TAX	TOTAL TAX
<b>GASOLINE AND DIESEL OIL (HIGHWAY):</b>			
City & County of Honolulu	16.0 ¢	16.5 ¢	32.5 ¢
County of Maui <sup>3</sup>	16.0	23.0	39.0
County of Hawaii	16.0	8.8	24.8
County of Kauai	16.0	17.0	33.0
<b>LIQUEFIED PETROLEUM GAS (HIGHWAY):</b>			
City & County of Honolulu	5.2 ¢	5.4 ¢	10.6 ¢
County of Maui <sup>3</sup>	5.2	11.5	16.7
County of Hawaii	5.2	2.9	8.1
County of Kauai	5.2	5.6	10.8
<b>ETHANOL (HIGHWAY):</b>			
City & County of Honolulu	2.4 ¢	2.4 ¢	4.8 ¢
County of Maui <sup>3</sup>	2.4	11.5	13.9
County of Hawaii	2.4	1.3	3.7
County of Kauai	2.4	2.5	4.9
<b>METHANOL (HIGHWAY):</b>			
City & County of Honolulu	1.9 ¢	1.8 ¢	3.7 ¢
County of Maui <sup>3</sup>	1.9	11.5	13.4
County of Hawaii	1.9	1.0	2.9
County of Kauai	1.9	1.9	3.8
<b>BIODIESEL (HIGHWAY):</b>			
City & County of Honolulu	4.0 ¢	8.3 ¢	12.3 ¢
County of Maui <sup>3</sup>	4.0	0.0	4.0
County of Hawaii	4.0	0.0	4.0
County of Kauai	4.0	0.0	4.0
NAPHTHA (Power-Generating Facility): All Counties	2.0 ¢	0.0 ¢	2.0 ¢
<b>COMPRESSED NATURAL GAS (HIGHWAY):</b>			
City & County of Honolulu	4.0 ¢	8.2 ¢	12.2 ¢
County of Maui <sup>3</sup>	4.0	11.4	15.4
County of Hawaii	4.0	4.4	8.4
County of Kauai	4.0	8.4	12.4
<b>LIQUEFIED NATURAL GAS (HIGHWAY):</b>			
City & County of Honolulu	4.0 ¢	8.2 ¢	12.2 ¢
County of Maui <sup>3</sup>	4.0	11.4	15.4
County of Hawaii	4.0	4.4	8.4
County of Kauai	4.0	8.4	12.4
<b>ENVIRONMENTAL RESPONSE, ENERGY, &amp; FOOD SECURITY TAX</b>			
All Counties, per barrel of petroleum products <sup>1</sup>	105.0 ¢	0.0 ¢	105.0 ¢
All Counties, per million BTU of fossil fuels <sup>2</sup>	19.0	0.0	19.0

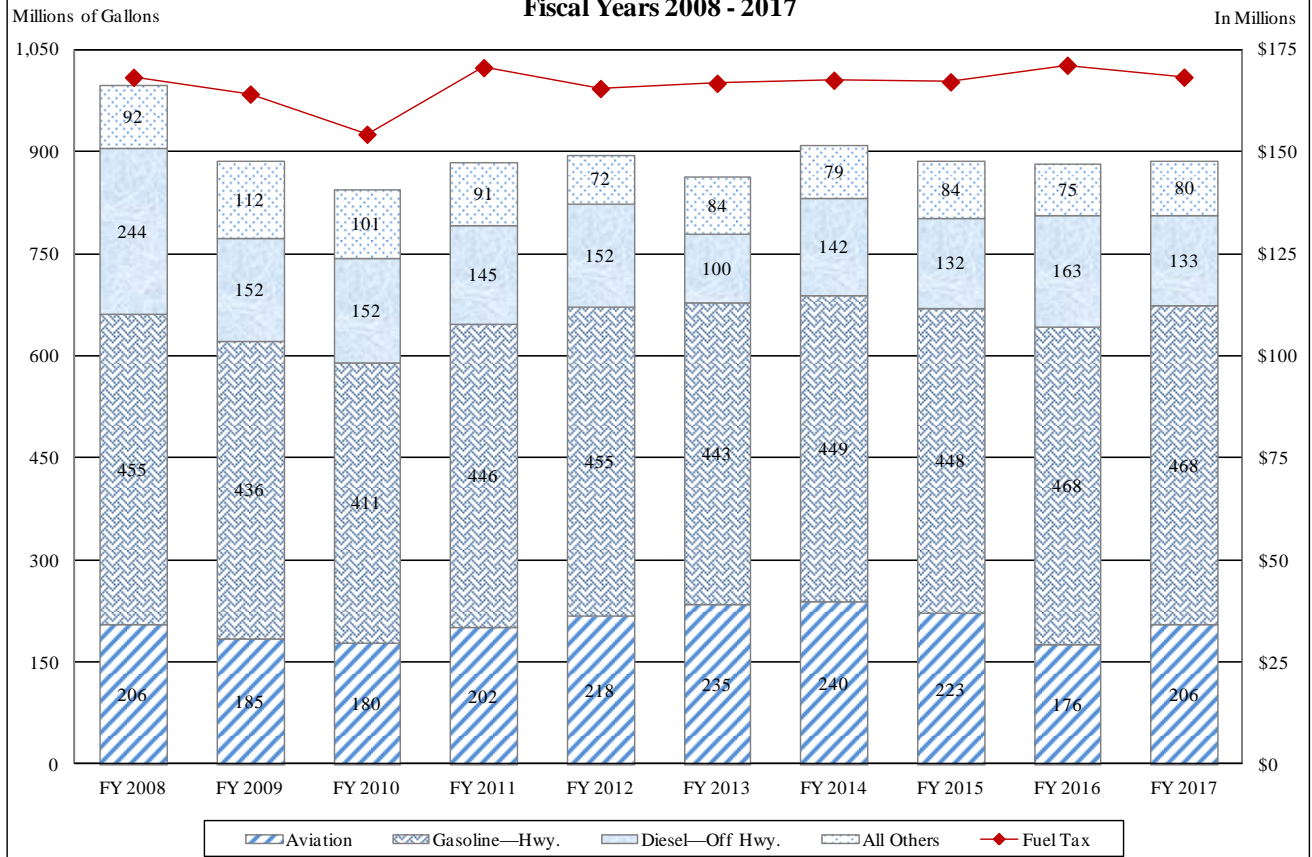
<sup>1</sup> Does not include aviation fuel.

<sup>2</sup> Does not include petroleum products. BTU = British thermal unit.

<sup>3</sup> Effective July 1, 2016, pursuant to Maui County Resolution 16-79.

<sup>4</sup> Gasoline used for agricultural equipment off highways, aviation fuel, and diesel oil used off highways are taxed by the State at 1 cent per gallon.

**Chart 1.9 - Fuel Tax and Trends in Fuel Consumption**  
**Fiscal Years 2008 - 2017**



**TABLE 1.5 - TAXABLE GALLONS OF FUEL CONSUMED**  
(In Thousands of Gallons)

	FY 2017	FY 2016	Difference	
			Amount	% Change
Gasoline	468,009	467,645	365	0.1
Diesel Oil - Off Highway	133,425	162,813	(29,388)	(18.1)
Diesel Oil - Highway	44,747	48,013	(3,266)	(6.8)
Liq. Pet. Gas - Highway	9	14	(5)	(38.4)
Small Boats - Gasoline	376	1,369	(992)	(72.5)
Small Boats - Diesel Oil	3,326	2,591	736	28.4
Aviation Fuel	205,910	176,390	29,520	16.7
Other Fuel <sup>1</sup>	31,601	23,173	8,428	36.4
<b>Total Gallons</b>	<b>887,404</b>	<b>882,008</b>	<b>5,396</b>	<b>0.6</b>
<b>Environmental Tax</b>				
Petroleum Products (Barrel) <sup>2</sup>	24,209,274	24,792,278	(583,004)	(2.4)
Fossil Fuels (MMBtu) <sup>3</sup>	5,643,391	4,835,187	808,204	16.7

<sup>1</sup> Other fuel includes ethanol, methanol, biodiesel, naphtha, compressed natural gas, and liquefied natural gas.

<sup>2</sup> Barrel = 42 U.S. gallons of petroleum products.

<sup>3</sup> MMBtu = 1 million British thermal units.

NOTE: Due to rounding, details may not add to totals.

TABLE 1.6 - ALLOCATION OF FUEL TAXES  
(In Thousands of Dollars)

	FY 2017 <sup>1</sup>	FY 2016 <sup>2</sup>	Difference	
			Amount	% Change
STATE HIGHWAY FUND				
Gasoline	\$ 74,157	\$ 76,915	\$ (2,758)	(3.6)
Diesel Oil - Off Highway	1,354	2,678	(1,325)	(49.5)
Diesel Oil - Highway	7,088	7,883	(795)	(10.1)
Liq. Pet. Gas - Highway	0	1	(0)	(38.4)
Other Fuel <sup>3</sup>	672	540	131	24.3
Subtotal	\$ 83,270	\$ 88,018	\$ (4,747)	(5.4)
Motor Vehicle	133,302	132,831	471	0.4
Rental Vehicle	53,187	54,872	(1,686)	(3.1)
TOTAL	\$ 269,759	\$ 275,721	\$ (5,962)	(2.2)
COUNTY HIGHWAY FUNDS				
City & County of Honolulu	\$ 51,992	\$ 52,765	\$ (773)	(1.5)
County of Maui	15,655	12,522	3,133	25.0
County of Hawaii	7,994	7,931	63	0.8
County of Kauai	5,636	5,459	177	3.2
TOTAL	\$ 81,278	\$ 78,677	\$ 2,601	3.3
BOATING SPECIAL FUND	\$ 1,662	\$ 1,684	\$ (22)	(1.3)
STATE AIRPORT FUND				
Aviation Fuel	\$ 2,059	\$ 2,807	\$ (748)	(26.6)
ENVIRONMENTAL RESPONSE REVOLVING FUND	\$ 1,267	\$ 1,288	\$ (21)	(1.6)
ENERGY SECURITY FUND	\$ 3,801	\$ 3,864	\$ (63)	(1.6)
ENERGY SYSTEMS DEVELOPMENT FUND	\$ 2,534	\$ 2,576	\$ (42)	(1.6)
AGRICULTURAL DEVELOPMENT & FOOD SECURITY FUND	\$ 3,801	\$ 3,864	\$ (63)	(1.6)
GENERAL FUND	\$ 15,090	\$ 15,359	\$ (269)	(1.8)

<sup>1</sup> Fuel tax collections were \$195,151 thousand for fiscal year 2017. Of the collections, \$390 thousand could not be distributed because the corresponding tax returns were not yet available.

<sup>2</sup> Fuel tax collections were \$198,404 thousand for fiscal year 2016. Of the collections, \$268 thousand could not be distributed because the corresponding tax returns were not yet available.

<sup>3</sup> Other fuel includes ethanol, methanol, biodiesel, naphtha, compressed natural gas, and liquefied natural gas.

NOTE: Due to rounding, details may not add to totals.



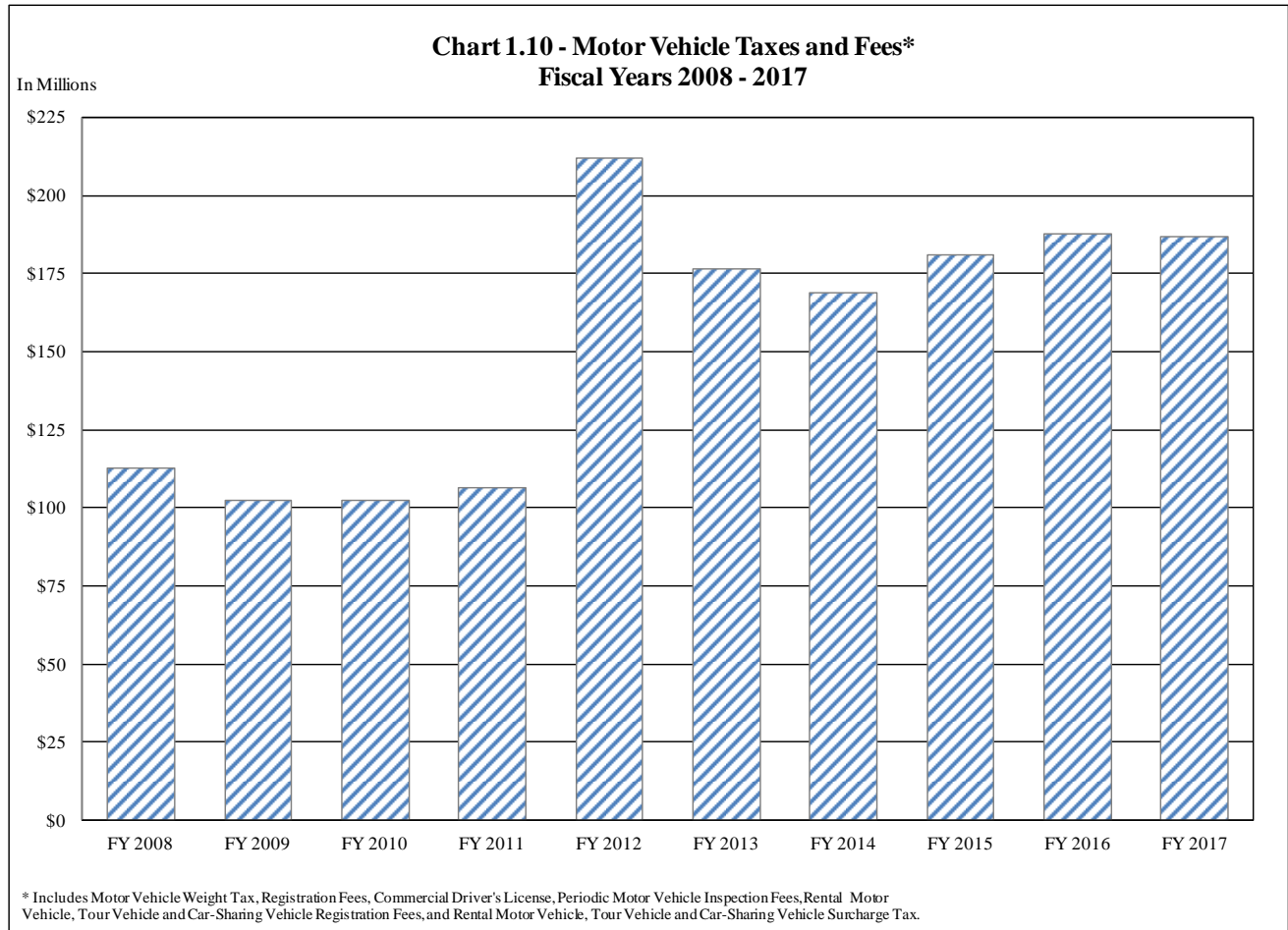
## **1.7 MOTOR VEHICLE TAXES AND FEES**

### ***1.7.1 Overview***

The State levies an annual registration fee per vehicle and a tax based on vehicle weight. The State also levies the rental motor vehicle, tour vehicle, and car-sharing vehicle surcharge tax (RVST). The tax on rentals of motor vehicles is imposed on the lessor. The rate of the tax is \$3.00 per day. The tax on tour vehicles is imposed on the tour vehicle operator. The rate of the tax is \$65 per month for each tour vehicle in the 26 passenger seat and over category, and \$15 per month for each tour vehicle in the 8 to 25 passenger seat category. The tax on motor vehicles that are rented or leased by a car-sharing organization is imposed on the car-sharing organization. The rate of the tax is 25 cents per half-hour. There is a one-time \$20 registration fee for those subject to any part of the RVST.

### ***1.7.2 Revenue***

For FY 2017, the State's motor vehicle taxes and fees (including the RVST) totaled \$186.5 million, compared to \$187.7 million in FY 2016, a decrease of 0.6%. Chart 1.10 shows the total motor vehicle taxes and fees for FY 2008 through FY 2017. The large increase in FY 2012 was caused by a temporary increase in the rate of the RVST to \$7.50 per day, which was in place for the period from July 1, 2011 to June 30, 2012. The collections for FY 2013 also reflect one month of collections at the higher tax rate, since the collections lag the liabilities incurred by one month.



## 1.8 CIGARETTE AND TOBACCO TAX

### 1.8.1 Overview

Wholesalers and dealers, as those terms are defined in section 245-1, Hawaii Revised Statutes (HRS), must pay an excise tax on the sale or use of tobacco products and on each cigarette or little cigar sold, used, or possessed. The tax per cigarette or little cigar was increased to 16 cents for sales on and after July 1, 2011. The excise tax on large cigars is 50% of the wholesale price and the excise tax on all other tobacco products (tobacco in any form except cigarettes, little cigars or large cigars) is 70% of the wholesale price. A \$2.50 tobacco tax license is required and must be renewed before July 1 each year. Cigarette wholesalers and dealers are required to affix a stamp to each individual cigarette package as proof that the tax has been paid. Every retailer engaged in the retail sale of cigarettes and other tobacco products is required to obtain a \$20 retail tobacco permit that must be renewed before December 1 each year.

### 1.8.2 Revenue

During FY 2017, collections of the cigarette and tobacco tax (including tobacco licenses) totaled \$124.1 million, compared to \$125.1 million in FY 2016, or a decrease of 0.8%. Chart 1.11 shows

the total collections of the tax for FY 2008 through FY 2017. The 16 cent tax per cigarette was distributed as follows in FY 2017: 2.000 cents went to the Hawaii Cancer Research Special Fund, 1.125 cents went to the Trauma System Special Fund, 1.250 cents went to the Community Health Centers Special Fund, and 1.250 cents went to the Emergency Medical Services Special Fund. Additionally, a total of \$1.9 million went to the Cigarette Stamp Administrative Fund and the Cigarette and Stamp Enforcement Fund. The remainder of the cigarette and tobacco tax went to the General Fund. Table 1.7 shows collections of the tobacco taxes and how the revenues were allocated in FY 2016 and FY 2017.

### ***1.8.3 Recent Legislation***

Act 238, SLH 2015, reduces the allocation of the tax on cigarettes to the Trauma System Special Fund from 1.500 cents per cigarette to 1.125 cents per cigarette, and caps the allocations to the Trauma System Special Fund, the Emergency Medical Services Special Fund and the Community Health Center Special Fund, effective July 1, 2015.

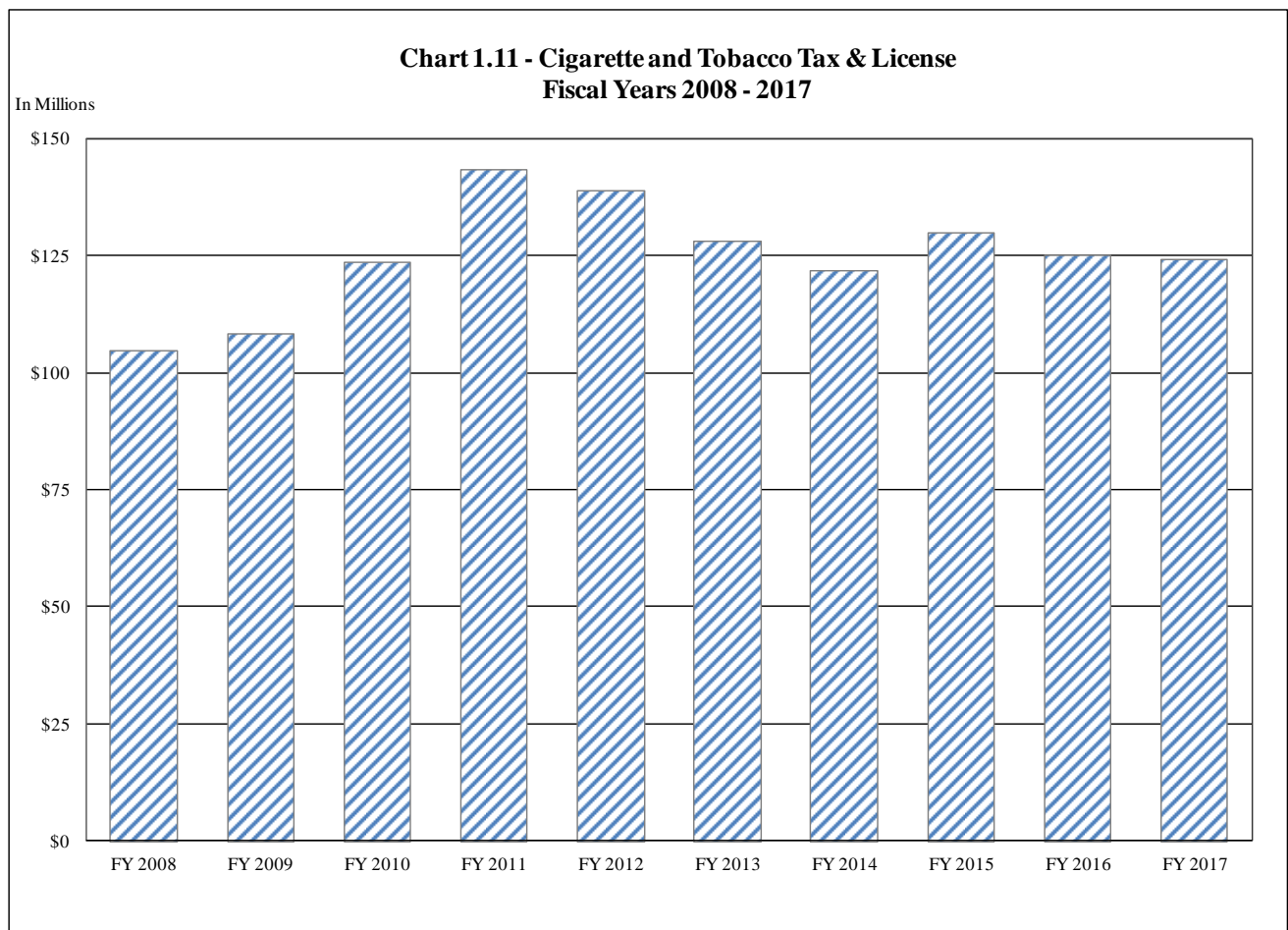


TABLE 1.7 - CIGARETTE & TOBACCO TAX  
(In Thousands of Dollars)

	FY 2017	FY 2016	Difference	
			Amount	% Change
Collection				
Tobacco & Licenses	\$ 124,066	\$ 125,093	\$ (1,027)	(0.8)
Distribution*				
Hawaii Cancer Research Fund	\$ 14,326	\$ 14,445	\$ (119)	(0.8)
Trauma System Fund	7,400	7,400	-	-
Emergency Medical Services Fund	8,800	8,800	-	-
Community Health Centers Fund	8,800	8,800	-	-
Cigarette Stamp Administrative & Enforcement Funds	1,947	1,964	(16)	(0.8)
General Fund	82,792	83,685	(892)	(1.1)
Total	\$ 124,066	\$ 125,093	\$ (1,027)	(0.8)

\*Details on distributions of the revenues are given in section 245-15, HRS.

NOTE: Due to rounding, details may not add to totals.

## 1.9 PUBLIC SERVICE COMPANY TAX

### 1.9.1 Overview

The public service company (PSC) tax is levied on public utility businesses in lieu of all taxes except income taxes, vehicular taxes imposed under chapter 249, HRS, the franchise tax on public utilities imposed under chapter 240, HRS, and the use tax imposed under chapter 238, HRS. Generally, the tax is applied to gross income from the business of public utilities for the preceding calendar year. The tax rates on the PSC's range from 0.50% (levied on sales for resale) to 8.20%. For a public utility, only the first 4.0% is realized by the State; any excess over 4.0% is distributed to counties that provide a real property tax exemption for property used by the public utility in its business. For a carrier of passengers by land between points on a scheduled route, the gross income from passenger fares is taxed at 5.35%, all of which is realized by the State.

### 1.9.2 Revenue

The PSC tax yielded \$122.2 million in tax, penalty, and interest in FY 2017, a decrease of 20.0% from the \$152.8 million collected in FY 2016. All of the revenues from the PSC tax are allocated to the General Fund. Chart 1.12 shows the total collections of the tax for FY 2008 through FY 2017.



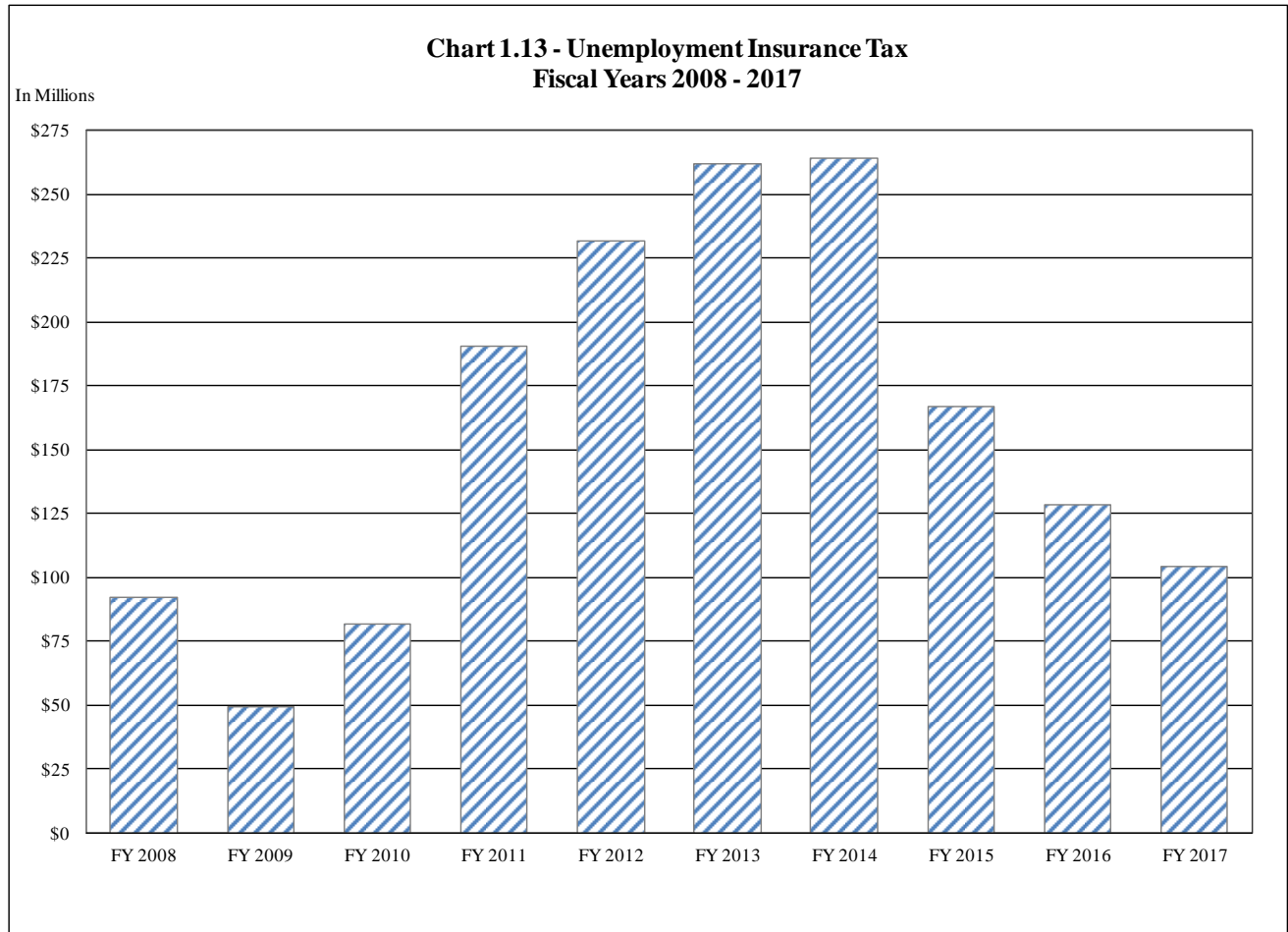
## 1.10 UNEMPLOYMENT INSURANCE TAX

### 1.10.1 Overview

The unemployment insurance (UI) tax (officially "employment security contributions") is imposed on wages paid by employers with one or more employees, with certain exemptions. The tax is experience rated. The UI tax rate for each year depends on the condition of the UI Trust Fund. The tax base represents the state's average annual wages reported by employers contributing to the Unemployment Trust Fund. For FY 2017, the tax base ranged from \$42,200 in CY 2016 to \$44,000 in CY 2017 and the contribution rate for new employers was 2.4% in both CY 2016 and CY 2017. Revenues from the tax go to the Unemployment Trust Fund. The Department of Labor and Industrial Relations administers the UI tax and the Department of Taxation collects the tax.

### 1.10.2 Revenue

For FY 2017, revenue from the UI tax totaled \$104.3 million, down by 18.9% from \$128.6 million collected in FY 2016. Chart 1.13 shows collections of the UI tax for FY 2008 through FY 2017.



## 1.11 INSURANCE PREMIUM TAX

### 1.11.1 Overview

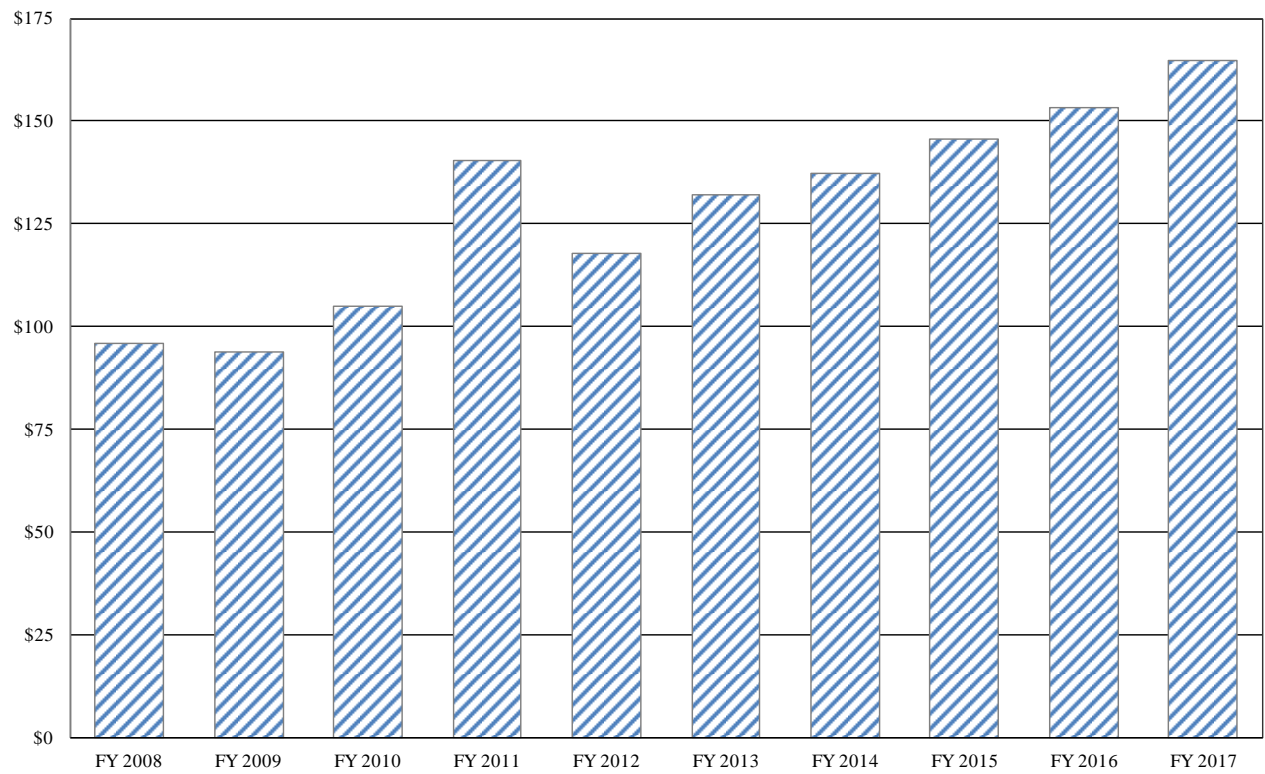
The tax on insurance premiums applies to insurance companies (underwriters) based on premiums written in Hawaii. The insurance premium tax is in lieu of all taxes except property tax and taxes on the purchase, use or ownership of tangible personal property. The tax rates are as follows: (1) Life Insurance, 2.75%; (2) Surplus Lines, 4.68%; (3) Ocean Marine, 0.8775% on gross underwriting profit; and (4) Other Insurance, 4.265%. To insurers who qualify, there is a 1.0% tax credit to facilitate regulatory oversight. The tax is administered and collected by the Insurance Commissioner, who is required to report to the Director of Taxation the amounts of all taxes collected under chapter 431, HRS.

### 1.11.2 Revenue

For FY 2017, the tax on insurance premiums totaled \$164.7 million, compared to \$153.2 million in FY 2016, an increase of 7.5%. Chart 1.14 shows collections of the tax for FY 2008 through FY 2017.

**Chart 1.14 - Tax on Insurance Premiums**  
**Fiscal Years 2008 - 2017**

In Millions



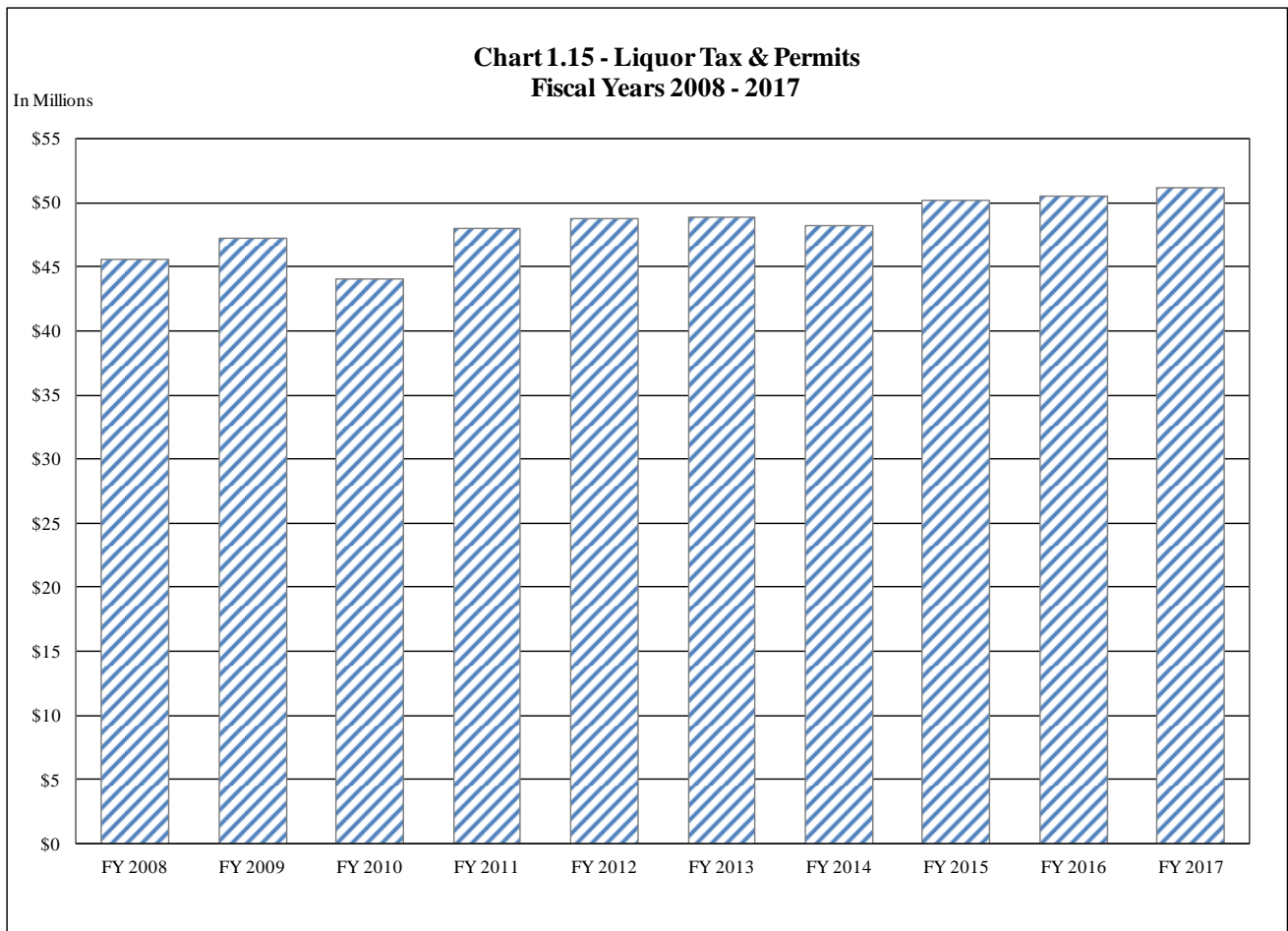
## 1.12 LIQUOR TAX

### 1.12.1 Overview

The tax on liquor is a gallonage tax imposed on dealers as defined in section 244D-1, HRS, and upon certain others who sell or use liquor. A \$2.50 liquor tax permit is required and must be renewed before July 1 each year. See section 244D-4, HRS, for exemptions from the tax. The tax rates per wine gallon are \$5.98 on distilled spirits, \$2.12 on sparkling wine, \$1.38 on still wine, \$0.85 on cooler beverages, \$0.93 on beer other than draft beer, and \$0.54 on draft beer.

### 1.12.2 Revenue

For FY 2017, the liquor tax and permit fees totaled \$51.2 million, an increase of 1.1% from the \$50.6 million collected in FY 2016. Chart 1.15 shows collections of the liquor tax and permit fees for FY 2008 through FY 2017.





## **1.13 CONVEYANCE TAX**

### ***1.13.1 Overview***

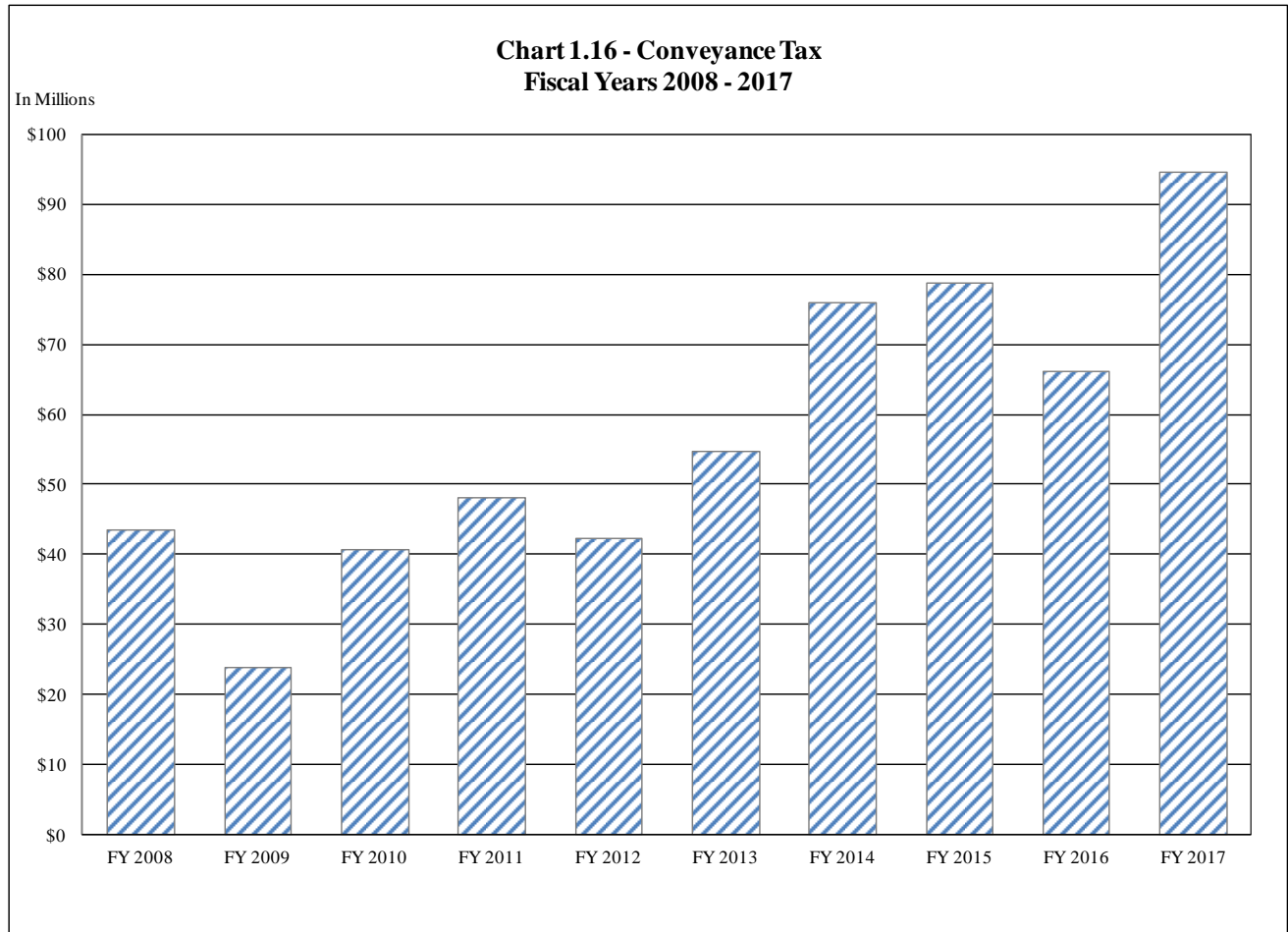
The conveyance tax is imposed on all documents transferring ownership or interest in real property and is based on the actual and full consideration paid or to be paid. For a sale of a condominium or single family residence, the rate of the conveyance tax depends on whether the purchaser is eligible for a county homeowners' exemption from the real property tax. If the purchaser is eligible for the exemption, or if the sale is of real property other than a condominium or single family residence, then the tax rate ranges from 10 cents per \$100 for properties with a value of less than \$600,000 to \$1 per \$100 for properties with a value of \$10,000,000 or more. If the purchaser is ineligible for the exemption, the tax rate for a sale of a condominium or single family residence ranges from 15 cents per \$100 for properties with a value of less than \$600,000 to \$1.25 per \$100 for properties with a value of \$10,000,000 or more. The conveyance tax is administered by the Department of Taxation, but it is collected by the Bureau of Conveyances in the Department of Land and Natural Resources.

### ***1.13.2 Revenue***

For FY 2017, revenue from the conveyance tax totaled \$94.5 million, compared to \$66.1 million in FY 2016, an increase of 43.1%. The revenues for FY 2017 were distributed as follows: 10% went to the Land Conservation Fund, provided that the amount in excess of \$6.8 million in any fiscal year is deposited into the General Fund; 50% went to the Rental Housing Trust Fund, provided that the amount in excess of \$38.0 million in any fiscal year is deposited into the General Fund; and the remaining 40% went to the General Fund. Chart 1.16 shows collections of the conveyance tax for FY 2008 through FY 2017.

### ***1.13.3 Recent Legislation***

Act 84, SLH 2015, eliminates the contributions of the conveyance tax to the Natural Area Reserve Fund, effective July 1, 2015, and caps the allocations to the other special funds.



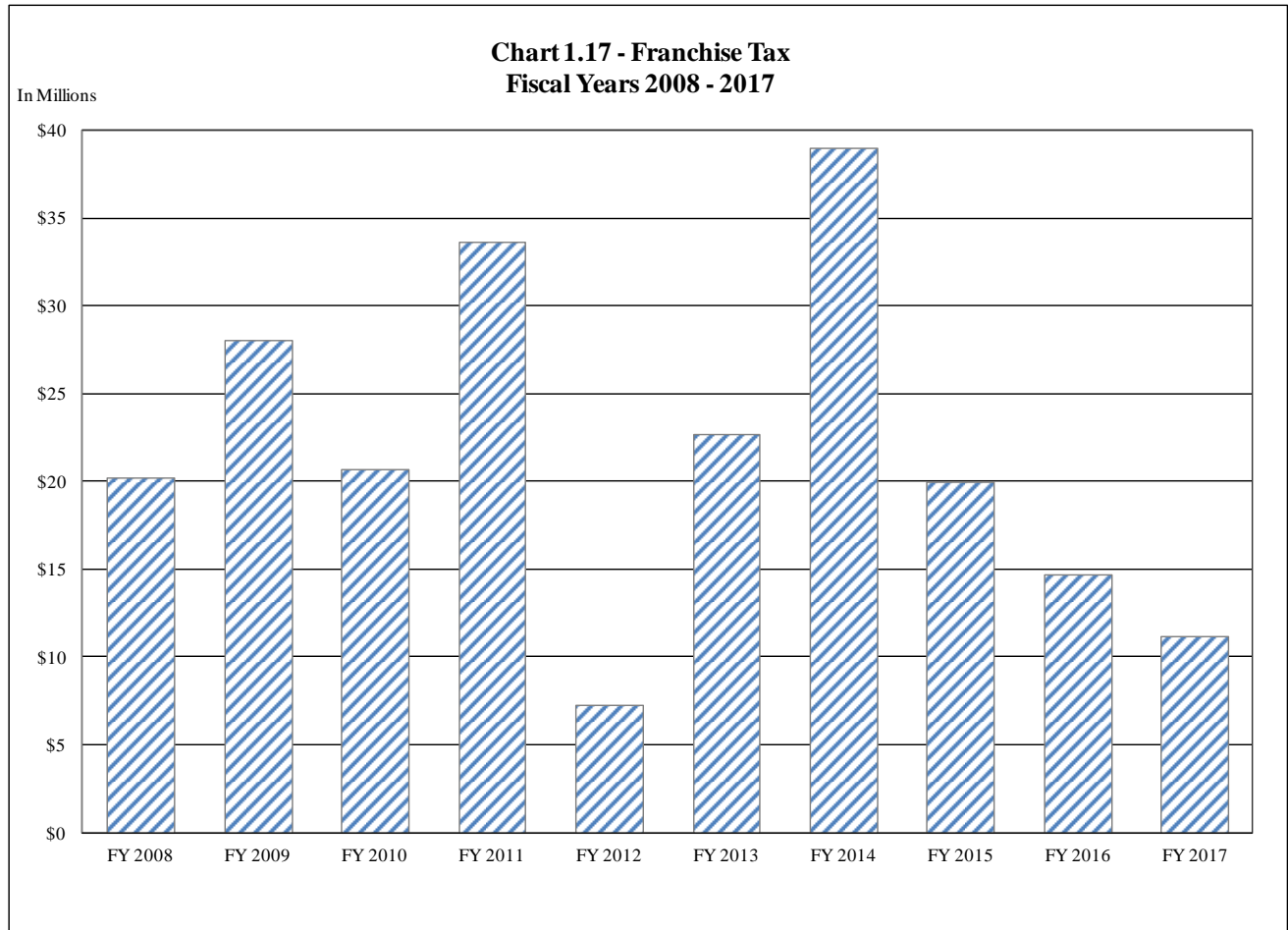
## 1.14 TAX ON BANKS AND OTHER FINANCIAL CORPORATIONS

### 1.14.1 Overview

The tax on banks and other financial corporations (the franchise tax) is levied on net income of banks, building and loan associations, development companies, financial corporations, financial services loan companies, trust companies, mortgage loan companies, financial holding companies, small business investment companies, and subsidiaries not subject to the tax imposed by chapter 235, HRS. The tax is in lieu of the net income tax imposed under chapter 235, HRS, and of the GET, but it uses the definition of net income from chapter 235, with modifications. The tax is levied on net income at the rate of 7.92%. The assessment date is January 1 of each year.

### 1.14.2 Revenue

For FY 2017, franchise tax collections totaled \$11.2 million, compared to \$14.7 million in FY 2016, a decrease of 23.9%. Chart 1.17 shows collections of the franchise tax for FY 2008 through FY 2017. Collections of the tax were low in FY 2012, due partly to a one-time transfer of \$16.5 million to the Litigated Claims Fund.



## 1.15 ESTATE AND TRANSFER TAX

### *1.15.1 Overview*

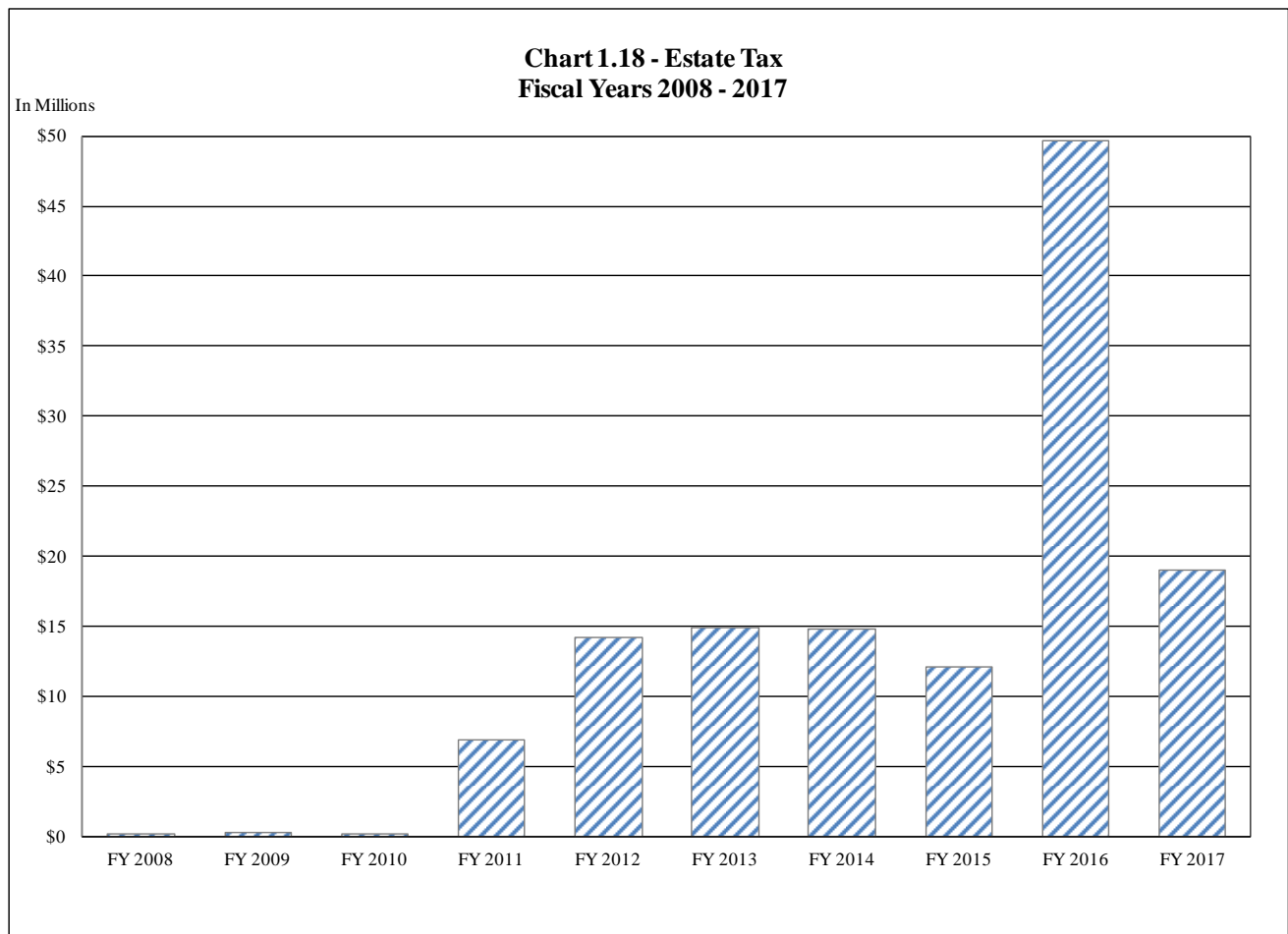
Hawaii's estate and transfer tax is levied on the transfer of a taxable estate. The taxable estate is based on the federal definition (with adjustments for nonresidents), but the State has its own tax rate schedule, with tax rates varying from 10.0% to 15.7%. The generation skipping tax is also based on the federal taxable transfer, but has its own tax rate (currently 2.25%).

### *1.15.2 Revenue*

For FY 2017, estate tax collections totaled \$19.0 million, compared to \$49.6 million collected in FY 2016. Chart 1.18 shows collections of the estate and transfer tax for FY 2008 through FY 2017.

### *1.15.3 Recent Legislation*

Act 156, SLH 2017, applies the estate and generation-skipping transfer tax to single member limited liability companies that do not elect to be taxed as corporations. The Act applies to decedents dying or taxable transfers occurring after December 31, 2016.



## 1.16 CITY AND COUNTY OF HONOLULU SURCHARGE TAX

### 1.16.1 Overview

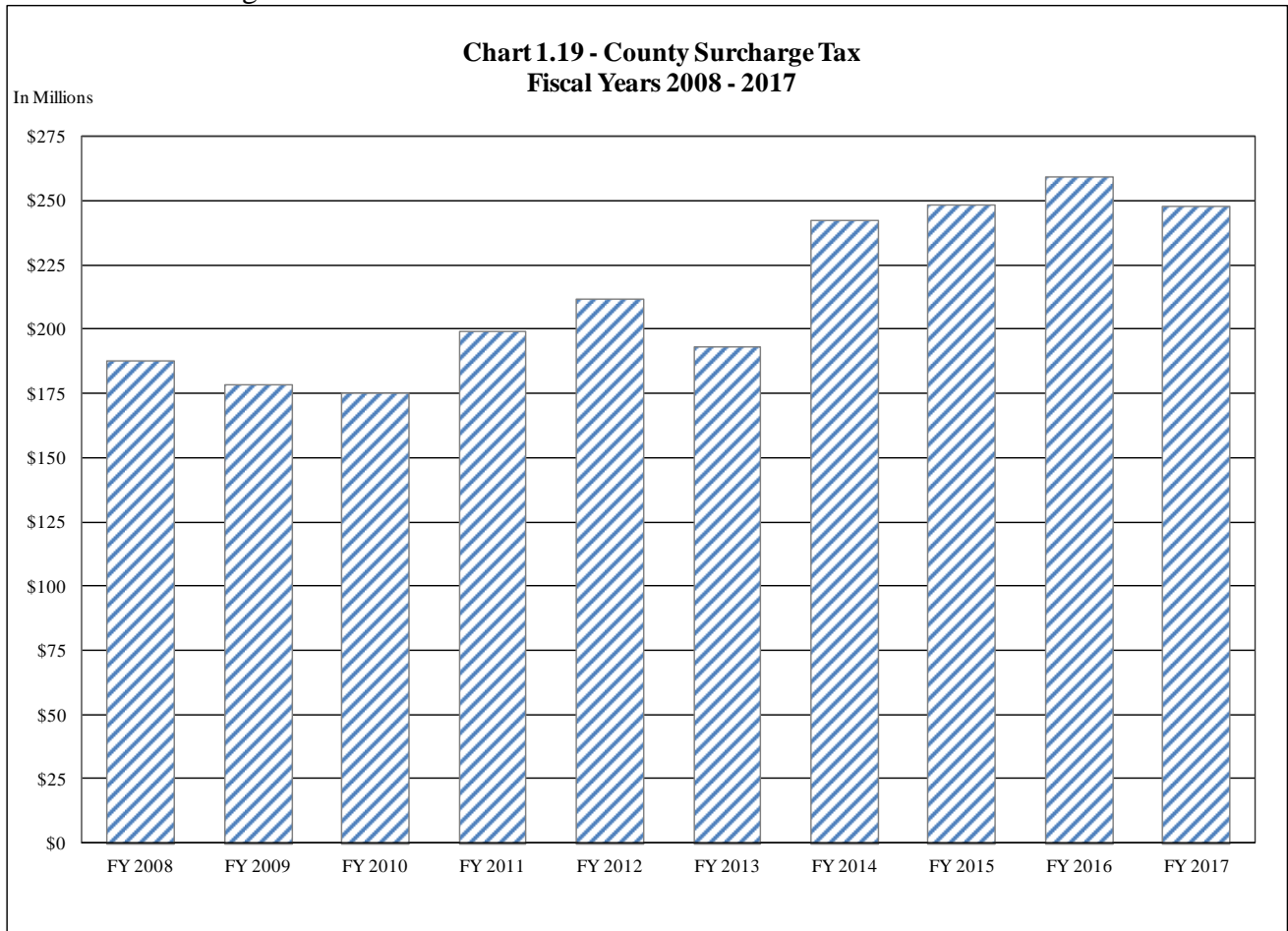
Act 247, SLH 2005, granted counties the authority to impose a county surcharge of no more than 0.5% on gross income that is subject to the State's GET at the rate of 4.0% to fund county public transportation systems. The Act specified that the surcharge be levied no earlier than January 1, 2007 and that it be automatically repealed on December 31, 2022. The Department of Taxation is required to administer and collect the surcharge for the counties. The City and County of Honolulu was the only county to adopt the surcharge, which took effect on January 1, 2007. The State keeps 10.0% of the collections from the county surcharge as administrative costs, and Honolulu County receives the remaining 90.0% of the collections.<sup>2</sup>

### 1.16.2 Revenue

For FY 2017, collections of Honolulu's county surcharge totaled \$248.2 million, a decrease of 4.3%

<sup>2</sup> The State will only collect 1.0% of the collections from the county surcharge to cover administrative costs beginning January 1, 2018.

from the \$259.2 million collected in FY 2016. Chart 1.19 shows collections of the county surcharge for FY 2008 through FY 2017.



## 1.17 TOTAL TAX COLLECTIONS

Total tax collections in FY 2017 amounted to \$7.34 billion, up by 1.2% from the \$7.25 billion collected in FY 2016. The Department collected the great majority of the total taxes (\$6.94 billion), but the counties collected \$133.3 million in State motor vehicle weight taxes and registration fees, the Insurance Commissioner (in the Department of Commerce and Consumer Affairs) collected \$164.7 million in insurance premium taxes, and the Bureau of Conveyances (in the Department of Land and Natural Resources) collected \$94.5 million in conveyance taxes. The total collections are shown in Table 1.8.

TABLE 1.8 - TAX COLLECTIONS  
(In Thousands of Dollars )

SOURCE OF REVENUE	FY 2017		FY 2016	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks - Financial Corps.	\$ 11,174	0.15	\$ 14,691	0.20
Conveyance	94,537	1.29	66,083	0.91
Employment Security Contributions	104,313	1.42	128,577	1.77
Fuel & Environmental <sup>3</sup>	194,761	2.65	198,136	2.73
General Excise & Use	3,239,225	44.14	3,206,154	44.23
Honolulu County Surcharge	248,158	3.38	259,248	3.58
Income - Corporations	76,761	1.05	93,036	1.28
Income - Individuals	2,192,803	29.88	2,116,859	29.20
Inheritance and Estate	18,968	0.26	49,613	0.68
Insurance Premiums	164,688	2.24	153,173	2.11
Liquor & Permits	51,167	0.70	50,590	0.70
Motor Vehicle Tax <sup>1</sup>	186,490	2.54	187,704	2.59
Public Service Companies	122,159	1.66	152,760	2.11
Tobacco & Licenses	124,066	1.69	125,093	1.73
Trans. Accom. Fees	20	0.00	13	0.00
Trans. Accom. Tax	508,357	6.93	446,781	6.16
All Others <sup>2</sup>	734	0.01	693	0.01
<b>TOTAL</b>	<b>\$ 7,338,382</b>	<b>100.00</b>	<b>\$ 7,249,205</b>	<b>100.00</b>

<sup>1</sup> Includes motor vehicle weight tax, registration fees, commercial driver's license, periodic motor vehicle inspection fees, rental motor vehicle, tour vehicle and car-sharing vehicle registration fees, and rental motor vehicle, tour vehicle and car-sharing vehicle surcharge tax.

<sup>2</sup> Includes fuel retail dealer permits, fuel penalty and interest, permitted transfers tax, and general excise fees.

<sup>3</sup> Fuel tax collections were \$195,151 thousand for fiscal year 2017. Of the collections, \$390 thousand could not be distributed because the corresponding tax returns were not yet available. Fuel tax collections were \$198,404 thousand for fiscal year 2016. Of the collections, \$268 thousand could not be distributed because the corresponding tax returns were not yet available.

NOTE: Due to rounding, details may not add to totals.

## 1.18 DISTRIBUTION OF TAXES

Of the \$7.34 billion in total tax collections in FY 2017, \$6.32 billion or 86.1% was deposited into the State's General Fund. The four counties received \$184.3 million from county fuel taxes and the TAT. In addition, \$248.2 million of county surcharge was collected for the City and County of Honolulu (before deducting the 10% administrative fee imposed by the State). The remaining tax revenues not deposited into the General Fund or transferred to the counties were distributed among various State special funds. The State Highway Fund received the largest portion, \$269.8 million. All of the unemployment insurance tax (the employment security contributions) went into the Unemployment Trust Fund for unemployment benefits. Table 1.9 shows allocations of taxes to the State's General Fund in FY 2016 and FY 2017. The distributions of the total tax collections among all funds in FY 2016 and FY 2017 are shown in Table 1.10.

TABLE 1.9 - STATE GENERAL FUND  
(In Thousands of Dollars)

SOURCE OF REVENUE	FY 2017		FY 2016	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks - Financial Corps.	\$ 9,174	0.15	\$ 12,691	0.20
Conveyance	49,737	0.79	26,415	0.43
General Excise & Use	3,239,225	51.29	3,206,154	51.76
Income - Corporations	76,761	1.22	93,036	1.50
Income - Individuals	2,192,341	34.72	2,116,392	34.17
Inheritance and Estate	18,968	0.30	49,613	0.80
Insurance Premiums	164,688	2.61	153,173	2.47
Liquor & Permits	51,167	0.81	50,590	0.82
Public Service Companies	122,159	1.93	152,760	2.47
Tobacco & Licenses	82,792	1.31	83,685	1.35
Trans. Accom. Tax	292,357	4.63	233,781	3.77
Environmental Tax	15,090	0.24	15,359	0.25
All Others *	755	0.01	708	0.01
<b>TOTAL</b>	<b>\$ 6,315,215</b>	<b>100.00</b>	<b>\$ 6,194,356</b>	<b>100.00</b>

\* Includes fuel retail dealer permits, fuel penalty and interest, permitted transfers tax, general excise fees, trans accom fees and rental vehicle fees.

NOTE: Due to rounding, details may not add to totals.

TABLE 1.10 - DISTRIBUTION OF COLLECTIONS  
(In Thousands of Dollars)

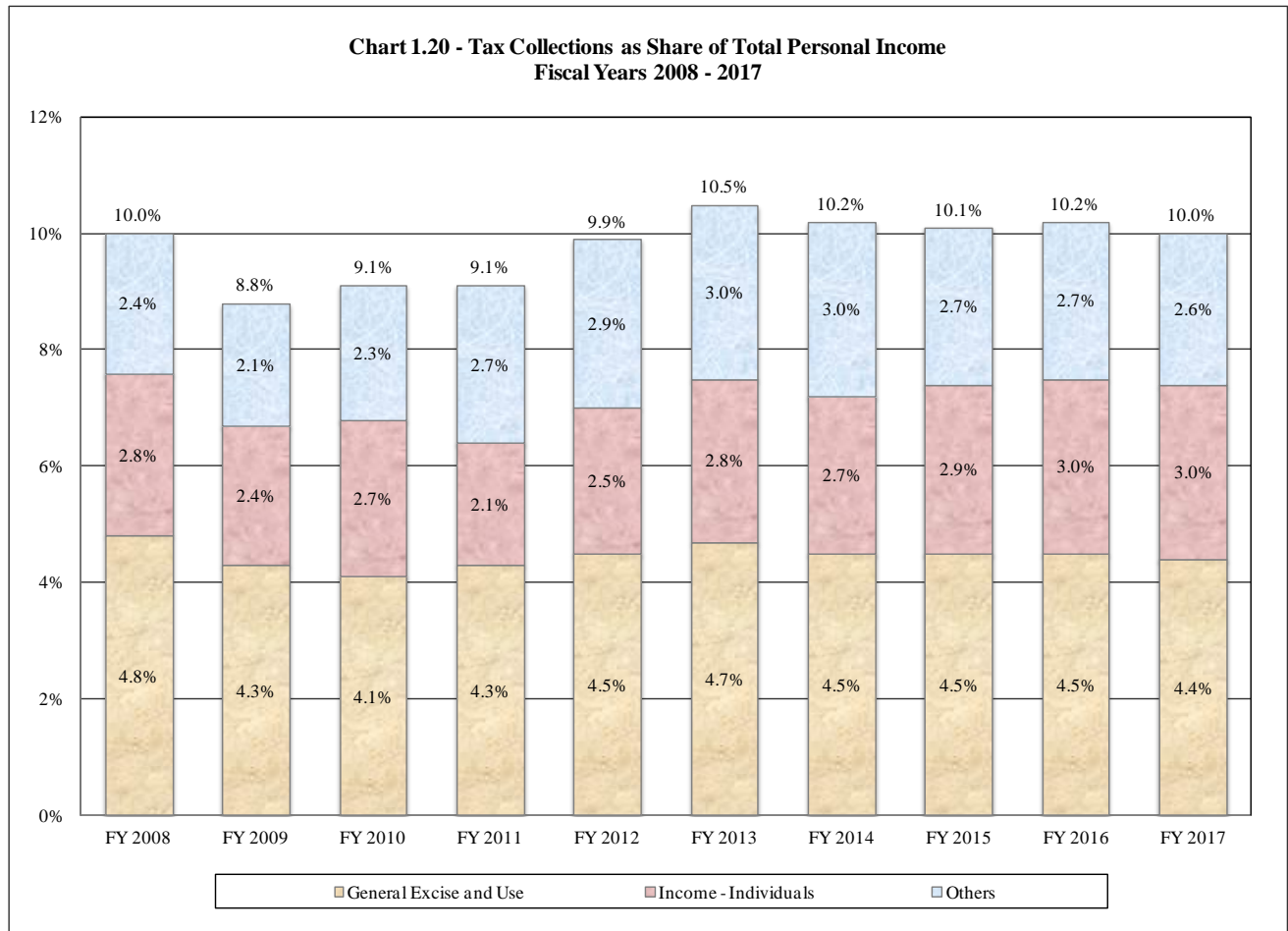
	FY 2017		FY 2016	
	Amount Distributed	% of Total	Amount Distributed	% of Total
<u>STATE FUND</u>				
State General Fund	\$ 6,315,215	86.06	\$ 6,194,356	85.45
State Highway Fund	269,759	3.68	275,721	3.80
State Airport Fund	2,059	0.03	2,807	0.04
Boating Special Fund	1,662	0.02	1,684	0.02
Environmental Fund	1,267	0.02	1,288	0.02
Cigarette Stamp Admin/Enf. Fund	1,947	0.03	1,964	0.03
Compliance Resolution Fund	2,000	0.03	2,000	0.03
Unemployment Trust Fund	104,313	1.42	128,577	1.77
Election Campaign Fund	164	0.00	180	0.00
Tourism Special Fund	82,000	1.12	82,000	1.13
Rental Housing Fund	38,000	0.52	33,057	0.46
Convention Center Fund	26,500	0.36	26,500	0.37
Public Libraries Fund	68	0.00	66	0.00
School Repairs & Maintenance Fund	74	0.00	72	0.00
Land Conservation Fund	6,800	0.09	6,611	0.09
Domestic Violence\Child Abuse Neglect Fund	155	0.00	149	0.00
Cancer Research Fund	14,326	0.20	14,445	0.20
Trauma System Fund	7,400	0.10	7,400	0.10
Emergency Medical Service Fund	8,800	0.12	8,800	0.12
Community Health Centers Fund	8,800	0.12	8,800	0.12
Energy Security Fund	3,801	0.05	3,864	0.05
Energy Systems Development Fund	2,534	0.03	2,576	0.04
Agricultural Development & Food Security Fund	3,801	0.05	3,864	0.05
Land and Development Fund	3,000	0.04	-	-
Turtle Bay Conservation Easement Fund	1,500	0.02	1,500	0.02
Subtotal - State	\$ 6,905,946	94.11	\$ 6,808,280	93.92
<u>HONOLULU COUNTY SURCHARGE</u>	\$ 248,158	3.38	\$ 259,248	3.58
<u>REVENUES TRANSFERRED TO COUNTIES</u>				
Other County Revenues				
Fuel Tax	\$ 81,278	1.11	\$ 78,677	1.09
Trans. Accom. Tax	103,000	1.40	103,000	1.42
Subtotal - Counties	\$ 184,278	2.51	\$ 181,677	2.51
<b>TOTAL</b>	<u>\$ 7,338,382</u>	<u>100.00</u>	<u>\$ 7,249,205</u>	<u>100.00</u>

NOTE: Due to rounding, details may not add to totals.



## 1.19 TRENDS IN TAX COLLECTIONS

Table 1.11 provides data on total tax collections for FY 2008 through FY 2017. Chart 1.20 shows total tax collections relative to total personal income (TPI) in the State for FY 2008 through FY 2017.<sup>3</sup> From FY 2008 to FY 2009, the ratio declined, caused by big declines in collections of both the GET and the IIT relative to TPI. The ratio grew from FY 2009 to FY 2013, but fell from FY 2013 to FY 2014. The ratio stayed roughly the same from FY 2014 to FY 2017.



<sup>3</sup> The chart uses the most recent figures from the Bureau of Economic Analysis (BEA) for TPI. The Bureau periodically updates TPI figures and the updates often extend back for a number of years.

TABLE 1.11 - HISTORICAL COLLECTIONS FOR SELECTED TAXES  
(In Thousands of Dollars)

SOURCE OF REVENUE	Fiscal Year				
	2008	2009	2010	2011	2012
General Excise and Use	\$2,618,787	\$2,417,580	\$2,316,434	\$2,495,807	\$2,697,951
Income - Individuals	1,544,835	1,339,056	1,528,110	1,247,153	1,541,051
Transient Accom. Tax & Fees	229,388	210,622	224,252	284,472	323,951
Unemployment Insurance	92,279	49,071	82,017	190,511	231,669
Motor Vehicle Tax <sup>1</sup>	112,448	101,991	102,319	106,166	211,742
Fuel and Environmental <sup>4</sup>	169,927	165,717	155,703	195,336	193,101
Public Service Companies	127,481	126,069	157,661	117,940	150,528
Tobacco and Licenses	104,624	108,164	123,489	143,293	138,798
Insurance Premiums <sup>2</sup>	95,742	93,720	104,721	140,456	117,617
Income - Corporations	85,081	53,522	59,186	34,573	73,026
Liquor and Permits	45,620	47,242	44,074	48,054	48,854
Conveyance	43,421	23,772	40,634	47,906	42,106
Banks - Financial Corporations	20,212	28,075	20,666	33,677	7,229
Total Collections <sup>3</sup>	\$5,478,491	\$4,944,133	\$5,134,807	\$5,292,193	\$6,004,268

SOURCE OF REVENUE	Fiscal Year				
	2013	2014	2015	2016	2017
General Excise and Use	\$2,944,487	\$2,880,541	\$3,048,207	\$3,206,154	\$3,239,225
Income - Individuals	1,736,007	1,745,810	1,988,194	2,116,859	2,192,803
Transient Accom. Tax & Fees	368,576	395,242	420,981	446,794	508,377
Unemployment Insurance	262,290	264,178	167,248	128,577	104,313
Motor Vehicle Tax <sup>1</sup>	176,295	168,726	180,755	187,704	186,490
Fuel and Environmental <sup>4</sup>	193,949	193,550	193,082	198,136	194,761
Public Service Companies	163,930	166,179	163,481	152,760	122,159
Tobacco and Licenses	127,881	121,742	129,851	125,093	124,066
Insurance Premiums <sup>2</sup>	131,906	137,179	145,679	153,173	164,688
Income - Corporations	100,988	87,021	52,319	93,036	76,761
Liquor and Permits	48,962	48,305	50,281	50,590	51,167
Conveyance	54,686	75,831	78,702	66,083	94,537
Banks - Financial Corporations	22,673	38,983	19,930	14,691	11,174
Total Collections <sup>3</sup>	\$6,541,300	\$6,581,424	\$6,900,042	\$7,249,205	\$7,338,382

<sup>1</sup> Includes State Motor Vehicle Weight Tax, Registration Fees, Commercial Driver's License, Periodic Motor Vehicle Inspection Fees, Rental Motor Vehicle, Tour Vehicle and Car-Sharing Vehicle Registration Fees, and Rental Motor Vehicle, Tour Vehicle and Car-Sharing Vehicle Surcharge Tax.

<sup>2</sup> Excludes Insurance Fees allocated to the General Fund, which were included in previous reports.

<sup>3</sup> Includes the Inheritance and Estate Tax, the Honolulu County Surcharge, fuel permits, interest and penalties on fuel taxes, general excise fees, and permitted transfers tax.

<sup>4</sup> Fuel tax collections were \$198,404 thousand for fiscal year 2016. Of the collections, \$268 thousand could not be distributed because the corresponding tax returns were not yet available. Fuel tax collections were \$195,151 thousand for fiscal year 2017. Of the collections, \$390 thousand could not be distributed because the corresponding tax returns were not yet available.

## **2.0 TAX ADMINISTRATION**

### **2.1 OVERALL PERFORMANCE**

The Department of Taxation consists of two divisions, six staff offices, a Public Information Officer, and a Taxpayer Advocate. The two divisions are the Tax Services and Processing Division and the Compliance Division. The six staff offices are the Administrative Services Office, the Rules Office, the Tax Research and Planning Office, the Information Technology Services Office, the Administrative Appeals Office and the Tax Practitioner Priority Office.

The total number of authorized permanent positions in the Department increased from 384 positions in FY 2016 to 388 positions in FY 2017. The Department's operating budget is a small fraction of total tax revenue. In FY 2017, the Department's operating expenses were \$24.3 million, down from \$25.5 million in FY 2009. The Department collected \$6.94 billion in taxes in FY 2017, so the cost of collecting each \$100 dollars of taxes was about 35 cents.

The Department has continued to encourage taxpayers to use electronic transmissions rather than paper returns. Although there has been a significant increase in electronic filing of tax returns and payments, over 1 million paper checks and over 2 million paper tax returns and other documents were manually processed by the Department in FY 2017.

The total number of audit cases completed by the Compliance Division (the Office Audit Branch and Field Audit Branch combined) increased by 5.1%, from 17,065 in FY 2016 to 17,936 in FY 2017. Total assessments, however, declined by 27.0%, from \$200.6 million in FY 2016 to \$146.4 million in FY 2017.

### **2.2 TAX SERVICES AND PROCESSING DIVISION**

#### ***2.2.1 Overview***

The Tax Services and Processing Division (TSP) is comprised of three branches: Taxpayer Services, Document Processing and Revenue Accounting. Aside from providing various services to both individual and business taxpayers, the Taxpayer Services Branch (TPS) performs functions relating to licensing and taxpayer account management. The Document Processing Branch (DP) manages the receiving, editing and centralized processing of tax information and processes payments received from both paper and electronic filings, and is further responsible for securing and depositing tax payments. The Revenue Accounting Branch (RA) maintains revenue control and reconciliation functions for all State tax revenues. RA is also responsible for the preparation of various revenue related reports, such as the monthly Preliminary Report (on revenues collected) and the Statement of Tax Operations (STO).

Based on DOTAX's Strategic Plan, the TSP Division continues to support initiatives that improve efficiency, effectiveness, and accountability. In FY 2017, the second rollout of the Tax System Modernization Project (TSM) was implemented to include processing of general excise tax, transient accommodations tax, use tax, rental motor vehicle and tour vehicle surcharge and county surcharge. This phase covers over 40% of State revenue collections. Additionally, Hawaii Tax Online (HTO), the department's web portal for payments and filing of tax returns, was launched. In

the first eleven months since the launch of HTO, more than 45% of the general excise and transient accommodations tax payers registered and used this web portal.

Key individuals from TSP continue to participate in the entire process of testing and implementation of the TSM. The third rollout, which occurred in August 2017, included processing of corporate, withholding, franchise, use and public service company tax types.

The Division's strategic plan for upcoming years continues to include the ongoing promotion of electronic filing and electronic payment transactions. These options make processing more efficient while minimizing reliance on staffing resources, particularly during peak filing periods. Electronic data further ensures accuracy and allows flexibility in reporting. With TSM underway, the Division looks forward to utilizing new technology and transforming business processes in order to shift focus toward higher levels of customer service to the taxpayer and precision in reporting, which helps fulfill our fundamental goals of increasing voluntary compliance and modernizing processing. The Division has begun organizational change management to bring forth an efficient and productive operation.

### ***2.2.2 Taxpayer Services Branch***

The Taxpayer Services (TPS) Branch is made up of three main sections:

- (1) Customer Inquiry – provides information and taxpayer assistance pertaining to all taxes administered by the Department
- (2) Account Management – performs computer-based error correction activities to allow expedient processing, posting and updating of tax returns and payments, and
- (3) Licensing – processes, issues and updates all licenses and permits issued by the Department

#### **Customer Inquiry**

The Division has continued to recruit and train appropriate candidates for vacant positions in Taxpayer Services during FY 2017. Below are statistics for the incoming calls to this Division. It is noted for FY2017 a large spike in calls, mostly due to the conversion of taxpayer identification numbers for the Rollout 2 tax types as well as taxpayers needing assistance with the new look and feel of Hawaii Tax Online. The greatest increase in calls occurred between January and March.

Below is a summary of incoming calls for past in fiscal years:

<u>FY</u>	<u>Total Incoming Calls</u>	<u>Total Calls Answered</u>	<u>Answer Rate</u>
2017	528,444	287,616	54%
2016	385,605	275,924	72%
2015	417,659	180,452	43%
2014	369,010	153,286	42%
2013	326,501	193,988	59%
2012	312,441	173,948	56%
2011	513,503	205,383	40%
2010	380,142	232,471	61%
2009	364,804	291,228	80%
2008	284,217	228,875	81%

For the same reasons as stated with the incoming call statistics, the number of taxpayers walking into the office has increased for FY2017. The average number of taxpayers served each month by fiscal year is as follows:

<u>FY</u>	<u># of Taxpayers</u>
2017	4,529
2016	3,582
2015	3,558
2014	4,290
2013	4,451
2012	5,416
2011	6,131

### Account Management

The primary function of Account Management is to review, analyze and correct errors or other inconsistencies on returns and payments that were identified by our computer system during processing and placed on a work list for manual review. In FY 2017, the team reviewed and posted 265,626 returns, payments, and other documents to the system that the automated system was initially unable to process. Again, this number increased over prior years due to Rollout 2. As the system becomes familiar with the documents, the manual review has decreased.

The chart below reflects monthly average postings of documents work-listed since FY 2011:

<u>FY</u>	<u># of Postings</u>
2017	22,135
2016	18,162
2015	16,434
2014	18,222
2013	14,849
2012	14,908
2011	16,758

### Licensing

The Licensing Section processed 36,361 business license applications in FY 2017, compared to 36,336 applications the previous fiscal year. However, 64% of the applications were filed online (23,430) versus only 56% in FY 2016. This comes as a result of a concentrated effort by the Division to encourage taxpayers to utilize the Department's online business license application option, Hawaii Business Express. The Section also processed 6,029 cancellations, a 40% decrease from FY 2016, which was inflated due to the clean up preparing for the TSM Rollouts.

#### **2.2.3 Document Processing Branch**

The main function of the Document Processing Branch (DP) is to quickly and efficiently process all tax returns and documents; to receive, secure, deposit, and account for tax payments; to ensure proper electronic storage and retrieval of documents; and to perform various functions relating to electronic filing. DP is comprised of six sections: Receiving and Sorting, Data Preparation, Imaging and Data Entry, Monetary Control, File Maintenance, and Electronic Processing.

Although there has been an increase in electronic filing of tax returns and payments, over 1.08 million paper checks and over 2.18 million paper tax returns and other documents were manually processed by the DPB.

For FY 2017, there were 2,193,555 (56%) paper tax returns, and 1,702,252 (44%) electronic tax returns processed. There was over \$7.59 billion in tax-related payments received, an increase of nearly \$200 million from FY 2016.

#### **2.2.4 Revenue Accounting Branch**

The main function of the Revenue Accounting Branch (RA) is to maintain accounting records for all tax revenues, refunds and adjustments, district transfers and closing adjustments, and preparation of all Journal Vouchers and Summary Warrant Vouchers. RA is also responsible for error resolution, reconciliation and reporting functions for all State tax revenues. Specific tasks include the preparation of the Daily Cash Collection Report (Oahu District), the Preliminary Report, the Statement of Tax Operations (STO).

The monthly Preliminary Report, which is released by the fifth working day of each month, is a summary of all revenues received by the Department, less the amount of tax refunds paid. The

STO is a formal, detailed report of State revenues that is based on the Preliminary Report and is prepared by the tenth working day of each month. The RA Branch has consistently and diligently met the critical deadlines for these reports throughout this fiscal year, as well as in past years.

The RA Branch also performs manual accounting activities for all miscellaneous tax collections (with the exception of the estate and transfer tax), prepares journal entries associated with the various administratively-established trust accounts and for other legislatively mandated purposes, maintains the manual accounting system for all protested payments and tax appeals, provides allocation reports to the Department of Accounting & General Services (DAGS) and the Department of Budget & Finance (B&F), accounts for all tax refunds, and handles all refund exception activities, such as returned checks, tracers, or forgeries.

## **2.3 COMPLIANCE DIVISION**

### **2.3.1 Overview**

The objective of the Compliance Division is to maximize taxpayer compliance with Hawaii's tax laws in a consistent, uniform, and fair manner. The Compliance Division is composed of the Oahu Office Audit Branch, the Oahu Field Audit Branch, the Oahu Collections Branch, and the Maui, Hawaii, and Kauai District Tax Offices. In addition to these branches, there are also the Special Enforcement Section (SES) and the Criminal Investigation Section (CIS). The Division has the following three programs to meet the objectives of the voluntary compliance, self-assessment tax system: (1) auditing/examination, (2) collection, and (3) taxpayer services (information dissemination).

The major statistical accomplishments of this year are the 30% increase in delinquent tax collections to \$283 million (see Table 2.3); and the marked increase in assessments from \$5 to \$9 million, principally on transient accommodations by the Special Enforcement Section (see Section 2.3.5). This is especially noteworthy in a year when the focus of the Compliance Division has been the building of the new tax computer system, and significant resources have been dedicated to this effort.

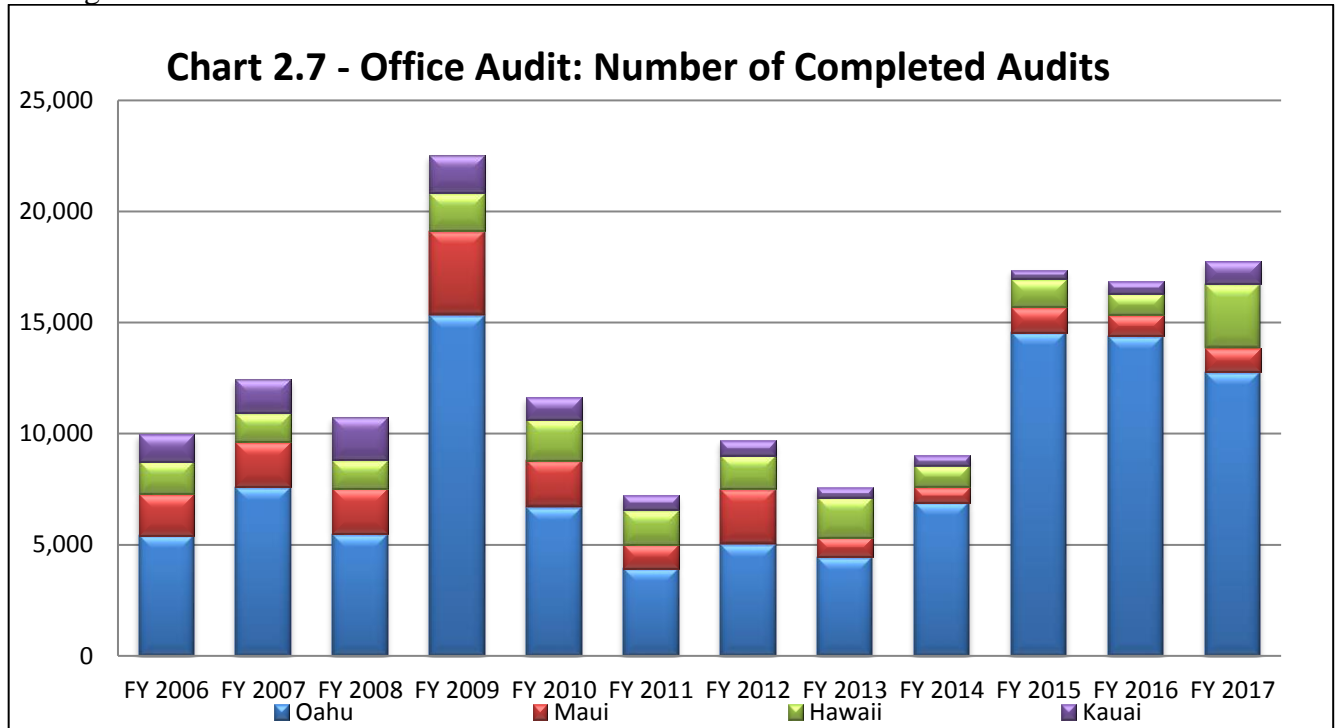
### **2.3.2 Office Audit Branch**

The Office Audit Branch performed examinations and audits to enhance voluntary compliance. In FY 2017, the Office Audit Branch completed 17,756 cases, an increase of 5.3% (890 cases) compared to FY 2016, the total dollars assessed was \$67.5 million, a decrease of 13.1% (\$10.2 million) compared to FY 2016. The majority of the audits were performed by Oahu Office Audit Branch, followed by the Hawaii District Office. In FY 2017, the Office Audit Branch processed the Estate and Transfer Tax returns and collected \$6.4 million for estate tax returns. Charts 2.7 and 2.8 (on the following page) show the number of audits completed and the dollars assessed by Office Audit for FY 2006 through FY 2017.

### **2.3.3 Field Audit Branch**

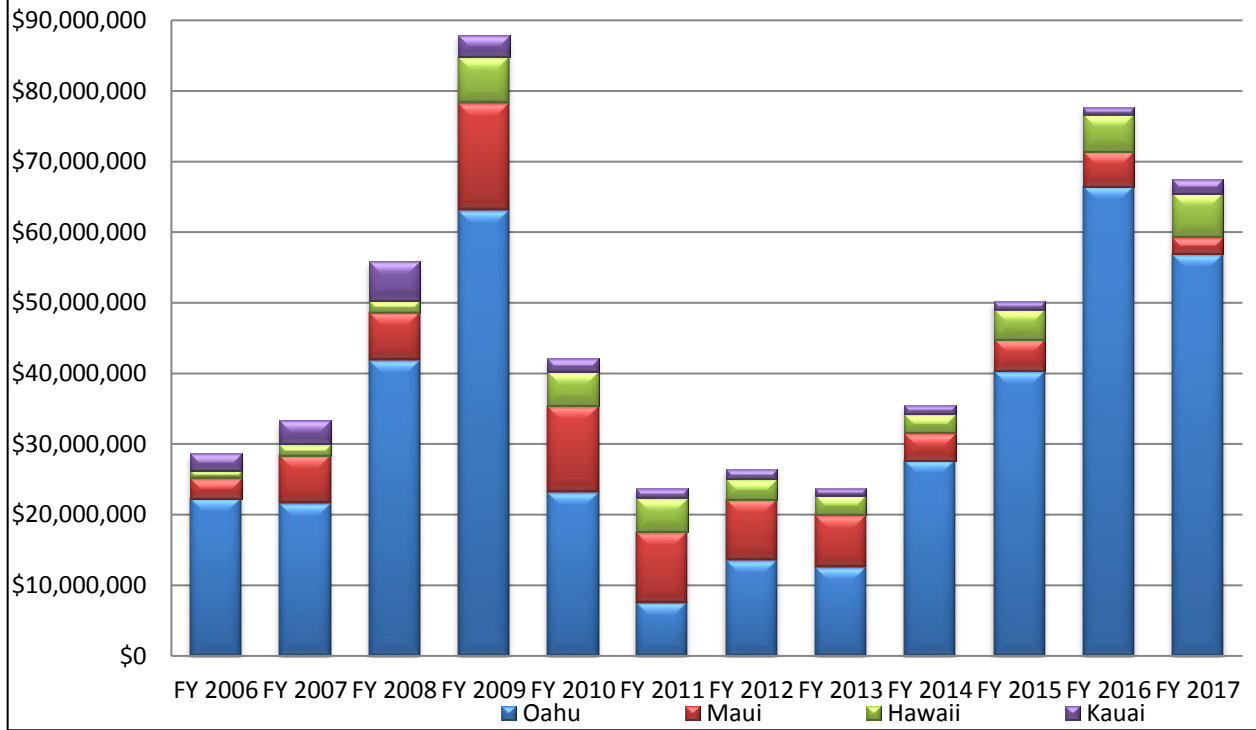
Similar to the Office Audit Branch, the Field Audit Branch performed examinations and audits to enhance voluntary compliance. The Field Audit Branch handled audits involving intricate auditing procedures. In FY 2017, the number of audits completed by Field Audit Branch completed was 180

cases, a decrease of 9.5% (19 cases) compared to FY 2016, and the total dollars assessed was \$78.9 million, a decrease of 35.8% (\$43.9 million). The decline in the number of audit cases in the Field Audit Branch was attributable to the demanding assignment of staff to work on TSM. Charts 2.9 and 2.10 show the number of audits completed and the dollars assessed by Field Audit for FY 2006 through FY 2017.

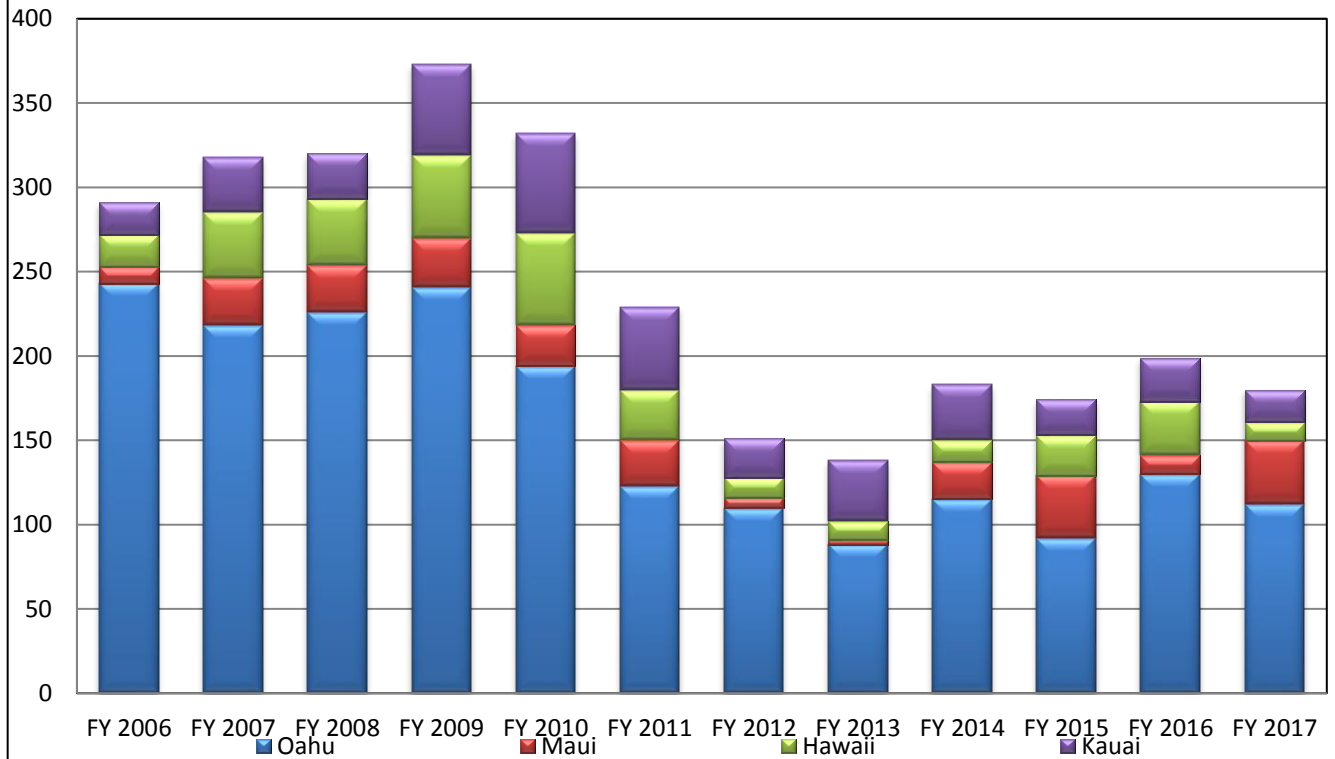




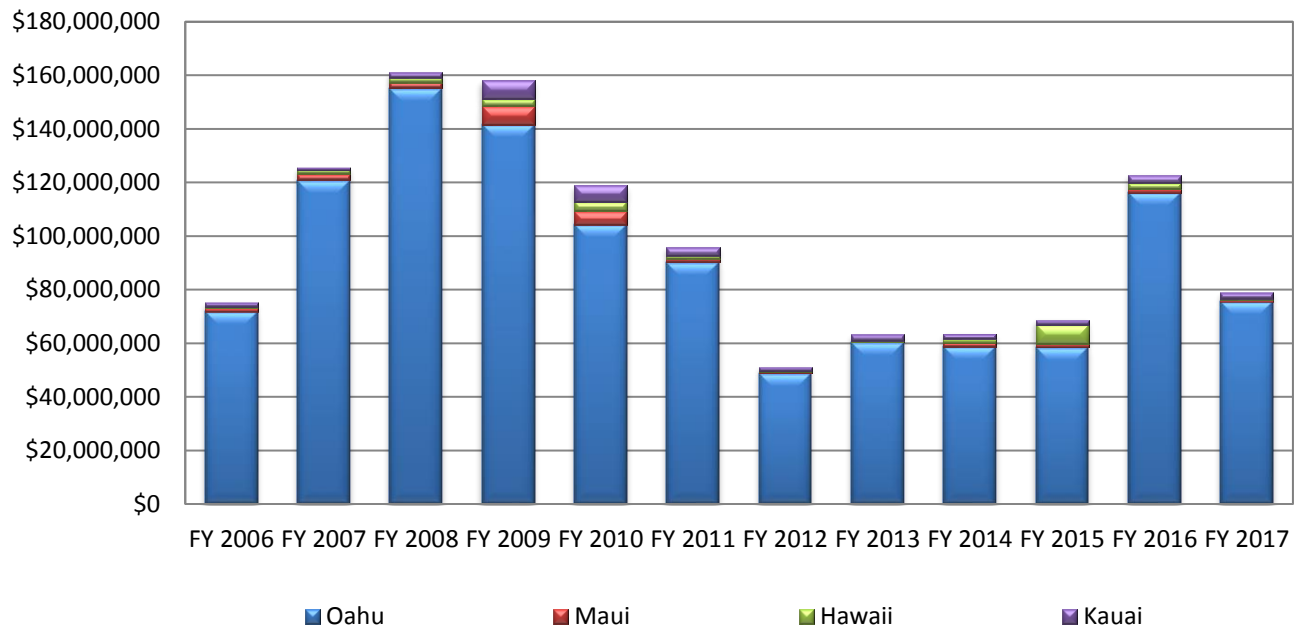
**Chart 2.8 - Office Audit: Dollars Assessed**



**Chart 2.9 - Field Audit: Number of Completed Audits**

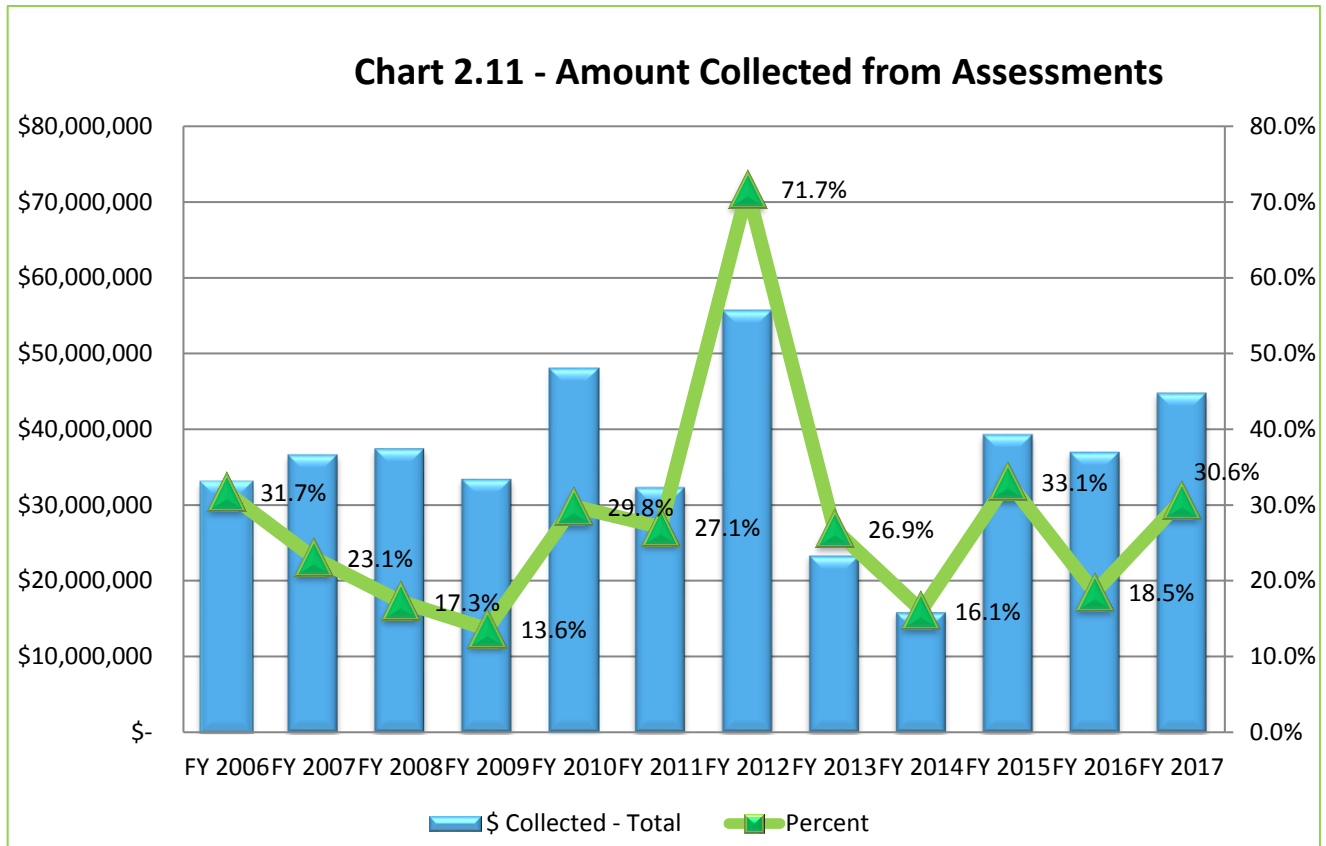


**Chart 2.10 - Field Audit: Dollars Assessed**



### 2.3.4 Revenue - Office and Field Audit Assessments

The amount collected at the time the audits were closed and prior to the mailing of any billing notices increased from \$37.0 million in FY 2016 to \$44.8 million in FY 2017.<sup>4</sup>



<sup>4</sup> The amounts assessed are the assessments generated during FY 2017. The amounts collected during FY 2017 may include assessments and settlements from prior fiscal years.

TABLE 2.1 - AMOUNTS ASSESSED FOR FY 2017

	<u>Office Audit</u>		<u>Field Audit</u>	
	Number of Audits	Dollar Assessed	Number of Audits	Dollar Assessed
Oahu	12,779	\$56,912,954	112	\$75,600,841
Maui	1,067	\$2,375,607	38	\$524,561
Hawaii	2,878	\$6,189,179	11	\$661,650
Kauai	1,032	\$2,058,733	19	\$2,118,784
Total FY 2017	17,756	\$67,536,473	180	\$ 78,905,836
Total FY 2016	16,866	\$77,696,490	199	\$122,880,670
Difference	890	\$(10,160,017)	(19)	\$(43,974,834)

### 2.3.5 *Special Projects*

Oahu Office Audit Branch conducted the following special projects during the fiscal year:

- Renewable Energy Tax Credit: The review of the tax credits claimed resulted in \$290,792 in assessments and adjustments.
- 1099-MISC: The examination of tax returns resulted in \$3.8 million in assessments and adjustments.
- Non-Filers: The examination of tax returns resulted in \$21.0 million in assessments and adjustments.
- HARPTA: During the fiscal year Oahu office audit examined gain computations inclusive of reviewing basis of properties resulting in \$135,138 in assessments.
- Itemized Deductions: The examination of tax returns resulted in \$1.8 million in assessments and adjustments.

Oahu Field Audit Branch conducted the following special projects during the fiscal year:

- Federal Contractors Project: This project, which targets unlicensed contractors working on federal installations, was started in 1983 and is an ongoing activity. This fiscal year, 4 audits were completed and resulted in \$332,829 in assessments.
- Referral Cases from the Criminal Investigation Unit: During this fiscal year, 1 case that was either originally considered for possible criminal prosecution or that arose pursuant to a criminal investigation was completed, resulting in a \$422,744 assessment.
- Research Tax Credit: During this fiscal year, 12 audit cases involving the research tax credit were completed resulting in \$2,791,295 in assessments.

- HARPTA: During this fiscal year, Field Audit has 2 cases of HARPTA issue, resulting in \$20,329,475.04 assessments.
- Multistate Tax Commission: During this fiscal year, 6 audit cases were completed that resulted in \$1,473,544 in assessments.

The Maui Office Audit Section conducted the following special projects during the fiscal year:

- Miscellaneous Deduction Project: Maui Office Audit assessed 93 taxpayers a total of \$177,331 in tax, \$4,493 in late filing penalties, and \$24,158 in interest.
- Renewable Energy Technologies Income Tax Credits: Maui Office Audit examined renewable energy income tax credits claimed in the amount of \$3,964,840 which resulted in the disallowance/assessments of credits in the amount of \$202,657.
- HARPTA Reviews: Maui Office Audit examined HARPTA/capital gains with the total of selling prices of \$278,259,110 which resulted in assessments or adjustments of \$33,500.
- The Maui Field Audit Section conducted the following special project during the fiscal year:
- Renewable Energy Technologies Income Tax Credits: Maui Field Audit reviewed renewable energy income tax credits claimed in the amount of \$10,751,933 which resulted in the disallowance of credits in the amount of \$357,611.
- HARPTA Reviews: Maui Field Audit examined HARPTA/capital gains with the total of selling prices of \$12,575,014 which resulted in assessments or adjustments of \$22,413.

The Hawaii District Office Audit Section conducted the following special projects during the fiscal year:

- Renewable Energy Tax Credits: The review of renewable energy tax credits claimed resulted in \$90,070 in assessments and adjustments.
- HARPTA Review: Examinations resulted in \$487,983 in assessments and adjustments of income, general excise, and transient accommodations taxes.
- 1099-MISC: Examinations in this area resulted in \$570,311 in general excise tax assessments.
- Other Leads: Examinations in this area resulted in \$258,454 in general excise tax assessments.
- Hawaii District Field Audit Section conducted the following special project during the fiscal year:
- Selected Exemptions: The Field Audit Section audited \$14,014,421 in exemptions claimed that resulted in tax assessments of \$327,877.

Kauai District Office Audit Section conducted the following special projects during the fiscal year:

- Referrals from Criminal Investigation Unit: The examination of tax returns resulted in \$42,500 in assessments and adjustments.
- 1099-MISC: The examination of tax returns resulted in \$69,400 in assessments and adjustments.
- Non-File: The examination of tax returns resulted in \$82,000 in assessments and adjustments.

The Kauai District Field Audit Section conducted the following special projects during the fiscal year:

- Renewable Energy Tax Credits: The review of renewable energy tax credits claimed totaling \$1,574,000 resulted in the disallowance of credits of \$197,100.
- Capital Goods Excise Tax Credit: The review of capital goods excise tax credits claimed totaling \$569,000 resulted in the disallowance of credits of \$500,000.

### ***2.3.6 Taxpayer Assistance Provided***

During FY 2017, the personnel in neighbor island district tax offices helped taxpayers properly file numerous tax returns and other documents over the telephone, at the service counter, and via correspondence. The Oahu Office Audit, Field Audit, and Collection units also provided support services to the neighbor island district tax offices and to the Oahu Taxpayer Services Branch when requested. Table 2.2 summarizes the number of times that taxpayer assistance was provided by the Maui, Hawaii, and Kauai District Tax Offices.

TABLE 2.2 – TAXPAYER ASSISTANCE PROVIDED BY  
MAUI, HAWAII AND KAUAI DISTRICT OFFICES

	FY2017	FY2016	<u>Difference</u>	
			Number	Percentage
Counter	70,942	73,568	(2,626)	(3.6)
Phone Services	45,988	51,694	(5,706)	(11.0)
Tax Clearances	5,589	5,542	47	0.8
Correspondence	15,041	19,872	(4,831)	(24.3)

The taxpayer services sections in the districts provide telephone and counter services, supplementing the centralized customer services provided by the Oahu TSP Division. The districts continue to receive a steady flow of telephone inquiries, and can use the statewide tax data system to assist with any tax inquiry.

Providing assistance to taxpayers is part of the Compliance Division’s continuing emphasis on taxpayer education and problem resolution. The Compliance Division believes that it is important to maintain taxpayers’ willingness to accurately and voluntarily comply with the State’s tax laws, so it will continue to emphasize its “taxpayer enabling and empowering activity.”

### 2.3.7 Collection Branch

The Compliance Division’s Tax Collections program consists of the Oahu collection branch and the collection sections in the Maui, Hawaii, and Kauai District Tax Offices. Collections of delinquent taxes totaled \$282.7 million for FY 2017, compared to \$217.6 million in FY 2016, an increase of \$65.1 million or 29.9%. The Oahu collection branch accounted for 83% of the statewide delinquent tax collections in FY 2017. During this period the Oahu collection branch experienced a 19% reduction in delinquent collectors due to special project assignments and attrition. New delinquency referrals were up \$75.8 million or 28.4%. Chart 2.12 shows delinquent collections for FY 2006 through FY 2017. The ending balance for FY 2017 includes penalty and interest (in addition to tax) for the first time. For comparison, Table 2.3 shows major performance measures for FY 2017 and FY 2016, including penalty and interest.

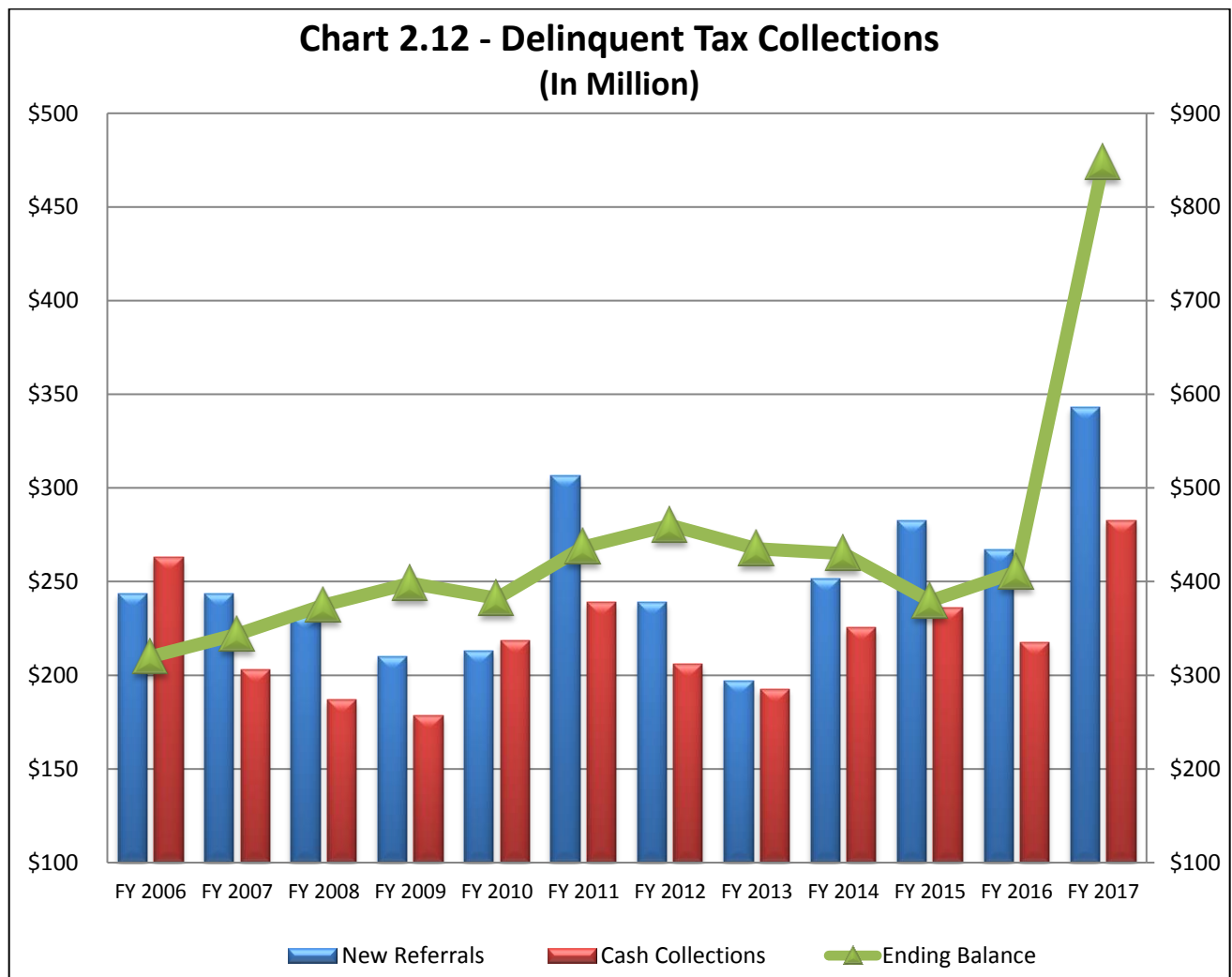


TABLE 2.3 - MAJOR PERFORMANCE MEASURES FOR FY 2017 AND FY 2016

Measure	FY 2017	FY 2016	Difference	
			Amount	Percentage
Total Delinquent Tax Balance (\$ Millions)	\$846.4	\$786.6*	\$59.8	7.6
Total New Delinquent Referrals (\$ Millions)	\$343.0	\$267.2	\$75.8	28.4
Total Cash Collected (\$ Millions)	\$ 282.7	\$217.6	\$65.1	29.9
Uncollectible Tax Write-Offs (\$ Millions)	\$0.5	\$23.3	\$(22.8)	(97.9)
Payment Plans Initiated	27,267	33,237	(5,970)	(18.0)
Tax Liens Filed	1,564	2,886	(1,322)	(45.8)
Levies Served	14,397	21,001	(6,604)	(31.4)

\*FY 2016 Total Delinquent Tax Balance has been restated to include penalty and interest to synchronize the comparability in the integrated accounts receivable tracking.

### ***2.3.8 Criminal Investigation Section***

During FY 2017, the Criminal Investigation Section (CIS) has achieved substantial outcomes in pursuing its investigative priorities. CIS conducted forty-two (42) investigations on entities with legitimate sources of income; and on individuals and criminal groups involved in illegal activities, such as narcotics trafficking, gambling, prostitution and other financial frauds. One (1) additional investigation relating to threats made against DOTAX employees was conducted.

CIS continues to work with the U.S. Attorney's Office for review and federal prosecutions of its investigations. During FY 2017, one fraudulent refund case was adjudicated with the defendant being sentenced to twenty four (24) months imprisonment and ordered to pay \$241,897 in restitution. Two (2) other tax preparer cases were also charged by the U.S. Attorney's Office during this period.

Moreover, CIS actively works with the County Prosecutor's Offices. During FY 2017, the Hawaii County Prosecutor's Office adjudicated a case involving a property management company with a conviction for one (1) count of Theft in the First Degree, ten (10) counts of failure to file tax returns relating to General Excise Taxes (GET) and Transient Accommodation Taxes (TAT) and two (2) counts of failure to collect and pay over taxes. The defendant was ordered to serve six (6) months imprisonment with four (4) years of probation; and ordered to pay restitution in the amount of \$138,960 to her victims. The Honolulu Prosecutor's Office adjudicated a case with a guilty plea to six (6) counts of tax evasion. The defendant was granted a deferral for a period of five (5) years and was ordered to pay restitution in the amount of \$16,919.

During FY 2017, CIS referred five (5) cases to the State of Hawaii Attorney General's Office for prosecution. Two (2) of the five (5) cases are pending plea agreements and the remaining cases are pending further action. One prosecution related to a local businessman with nine (9) separate business entities; and who made unsolicited admissions after the fact and filed their General Excise Tax Returns with payments. The other pending plea arrangement relates to a tax preparation firm. One (1) tax protester case is pending trial. CIS further concluded a prior FY 2016 criminal case with a



civil settlement of over \$175,000.

CIS is currently investigating other tax preparers covering all of the islands. These cases will be referred to the State of Hawaii Attorney General's Office upon completion. CIS continues to pursue investigations on mainland companies doing business in the State of Hawaii; and on individuals and criminal groups involved in illegal activities.

Completed investigations that were not referred for criminal prosecution were turned over to the appropriate Oahu Office Audit Branch, Field Audit Branch or Outer Island District Offices for further civil examination. Over four hundred (400) referrals were made for civil assessments. For FY 2017, these referrals amounted to over \$984,976 in additional assessments. These assessments were mutually exclusive to those made for prior year adjudicated criminal cases.

The Criminal Investigation Section will continue to be innovative in its investigative approach and strive to improve its processes for the Department of Taxation.

### ***Criminal Investigation/Enforcement Action***

During FY 2017, the Criminal Investigation Section continued to promote voluntary compliance through the aggressive enforcement of Hawaii Tax Laws and Regulations. It is estimated that CIS investigative efforts will have yielded approximately \$4,733,960 in restitution, assessments, penalties, and interest that would have otherwise not been realized by the State of Hawaii. In FY 2016, CIS investigative efforts yielded \$4,415,603. An additional \$872,380 in criminal collections was made in FY 2017.

### ***2.3.9 Special Enforcement Section***

The Special Enforcement Section (SES) was established in 2009, through the *Cash Economy Enforcement Act*. Its goal is to ensure that all sectors of Hawaii's economy, especially those that conduct a significant portion of business transactions in cash ("cash economy"), pay their fair share of taxes. In FY 2016, SES was given additional responsibilities for ensuring that short-term vacation rental operators comply with the state's transient accommodations tax laws.

The SES has broad legal authority to conduct civil investigations of reported or suspected violations of tax laws. It conducts complex financial investigations to determine correct income subject to tax by securing and examining books, records and other corroborating evidence. It executes a wide range of activities which include receiving and investigating complaints, developing leads through various sources, securing delinquent and amended tax returns and payments from taxpayers, conducting site visits, inspections, surveys, and training sessions at various events, business locations, and short-term rental sites throughout the state for the purpose of educating the public and business operators about their tax obligations and checking on tax compliance.

During FY 2017, SES initiated several projects that utilize publicly available and confidential database sources to develop leads on taxpayers who are potentially not compliant with transient accommodations and general excise tax laws. These projects utilized new resources made available by TSM to evaluate large amounts of data. As a result, significant numbers of leads have been generated indicative of unreported and under-reported income subject to transient accommodations

and general excise taxes. It is anticipated that these projects will result in substantial additional transient accommodations and related general excise tax collections in FY 2018 and beyond.

In FY 2017, SES continued to achieve significant gains in bringing taxpayers into compliance and in collecting tax revenues. SES collected \$5,268,362 in total revenue in FY 2017, as compared with \$3,505,618 in FY 2016, an increase of over 50%. Furthermore, with the assistance of Office Audits, \$487,245 of taxes were also assessed in FY 2017. Additional details of SES's accomplishments are as follows:

	<u>FY 2017</u>	<u>FY 2016</u>	<u>FY 2015</u>
Complaints Received	307	364	391
Vendors Educated on Compliance of Tax Laws	1,331	1,470	1,554
Number of Events Visited Throughout the State	25	28	60
Number of Extensive Investigations Completed	76	31	34
Total Liability on Returns Secured from Taxpayers	\$8,724,539	\$4,583,190	\$2,332,782
Total Revenue Collected from Taxpayers	\$5,268,362	\$3,505,618	\$1,619,235

## **2.4 STAFF OFFICES**

### ***2.4.1 Administrative Services Office***

#### ***2.4.1.1 Fiscal Office***

The Administrative Services Office submitted the biennium budget for FY 2018 to the 2017 Legislature. The Legislature appropriated \$28.4 million for FY 2018 for operating expenses. The Legislature did not approve the requested \$18.8 million CIP funding for the Department's Tax System Modernization Project (TSM), therefore the required funds to continue the TSM Project will impact FY 2018 Operating Budget. To prepare for medical marijuana tax payments the Legislature appropriated \$500,000 to improve the safety and security of the Department's facilities.

For fiscal year 2017, \$28.8 million was appropriated for the Department. In discharging its duties and responsibilities, the Department incurred operating expenses of \$24.3 million for the year. The Department collected \$6.94 billion in net tax revenues in fiscal year 2017, so the cost to collect \$100 of taxes was about 35 cents.

#### ***2.4.1.2 Personnel Management***

In FY 2017 the Personnel Department's focused on filling vacancies, outside recruitment, internal promotions and retention programs. Personnel staff also participated in the development of the new payroll system, reviewing and organizing files to transition into the new payroll system.

During that fiscal year, the Department's total vacancy rate for permanent positions increased 12.9% or 8 positions attributed to retirements, internal promotions, and resignations. Vacancies in the Staff Offices decreased by 38.5%, Compliance Division increased by 38.7% and Tax Services & Processing increased by 5.6%. The Department has a total of 388 authorized permanent

positions: 316 Oahu, 29 Hawaii (Hilo/Kona), 25 Maui/Molokai, and 18 Kauai.

### ***2.4.2 Rules Office***

The Rules Office is comprised of the Rules staff and the Technical Section. The function of the Rules Office is to serve as a resource for complex policy recommendations and complex internal support. The Rules Office also assists in the Department's implementation of new legislation and in creating and maintaining the Department's tax forms, form instructions, and publications.

#### ***2.4.2.1 Rules Staff***

The Rules staff serves as the Department's internal advisory arm to the Director of Taxation on tax policy and advises the Director's Office and the Department on legislative and tax policy issues. Litigation and other external legal matters are handled exclusively by the Tax Division of the Department of the Attorney General.

In addition, the Rules staff assists, counsels, and represents the Department's compliance personnel with tax disputes and other administrative tax controversies. For example, the Rules staff provided assistance to the Department's compliance function in interpreting issues under audit, settlement negotiations and closings, and appeared on behalf of the Department before the Boards of Review. The Rules staff also assisted the Tax Division of the Department of the Attorney General with the judicial tax appeals and provided support to the Department's Tax System Modernization project.

The Rules staff also testified at legislative hearings on behalf of the Director, provided training for Department personnel, and spoke at several workshops for tax practitioners. For the 2017 legislative session, the Rules staff drafted and submitted 6 bills sponsored by the administration, which were submitted to both the House of Representatives and the Senate. Prior to the start of the legislative session, the Rules staff also reviewed and commented on proposed tax legislation submitted by other executive departments.

After reviewing the bills introduced to the 2017 Legislature, the Director's Office and the Rules staff determined there were approximately 370 measures proposing tax law changes and analyzed them in depth. The measures were tracked throughout the legislative session and written testimonies were prepared each time a tax measure was heard by the Legislature. In addition, the Rules staff drafted letters to legislative committee chairs to respond to specific questions raised during hearings or to address specific concerns of committee members.

During the fiscal year, the Rules staff prepared Tax Announcements, Tax Information Releases, letter rulings, Administrative Directives, and other publications. During FY 2017, 8 Tax Announcements were issued. Since 2009, when it became the Department's policy to publicly release taxpayer letter rulings in redacted form, 60 redacted letter rulings have been released.

In FY 2017, the Department promulgated administrative rules relating to the Motion Picture, Digital Media, and Film Production Income Tax Credit, Relating to Payments by EFT Program Participants, Registration of Representatives, Last Known Address, and Substantial Gainful Business or Occupation.

The Rules staff also reviewed and certified 52 requests for the credit for research activities pursuant

to HRS § 235-110.91.

#### ***2.4.2.2 Technical Section***

The Technical Section is tasked with varying responsibilities to carry out the Department's projects, goals and initiatives, and to support the Department's operational needs. Specifically, the Technical Section assists and advises all divisions within the Department, as well as outside parties such as individual and corporate taxpayers and tax professionals, on complex areas of the state tax laws. For FY 2017, the Technical Section responded to 1,437 email inquiries and 3,626 telephone inquiries. They also responded to formal requests which includes requests for letter rulings or information letters, determinations of tax status (such as for eligibility for the general excise tax exemptions for air-pollution control facilities), and multi-level marketing agreements as well as tax surveys and questionnaires from other government agencies, educational institutions, and major tax service product providers.

The Technical Section also reviews, researches, analyzes, and provides comments and recommendations on the technical and procedural aspects of legislative bills, administrative rules, and tax information releases. The staff is responsible for revising or creating the State's tax forms and instructions, incorporating all applicable federal and state tax law changes. For FY 2017, the Technical Section reviewed 289 tax forms, 55 tax form instructions, 77 Tax Modernization System letter templates and 19 Tax Publications. The Technical Section also developed 1 new tax form and 1 new tax form instruction, and made obsolete 11 tax forms and 2 tax form instructions. As part of the forms process, the department has a Forms Reproduction Policy under which companies who reproduce state tax forms, such as tax preparation software companies, must submit their facsimiles for review and for testing applicable forms through the department's tax return scanning machines. For FY 2017, 694 tax forms were submitted to the Technical Section for review, testing and approval.

Other duties of the Technical Section include analyzing and reviewing certain applications for tax exemptions. In FY 2017, 144 applications for an exemption from the general excise tax were received, 132 applications were reviewed and approved, 67 applications are pending further action and 7 applications were cancelled due to lack of response to a request for additional information or the organization did not qualify as exempt under §237-23(b), HRS. In addition, 2,931 applications for conveyance tax exemptions were reviewed and processed.

#### ***2.4.3 Tax Research and Planning Office***

The following are the main functions of the Tax Research and Planning (TRP) Office: (1) prepare reports on data collected by the Department, including reports on collections of the State's various taxes, on the income patterns of individual and business taxpayers, and on tax credits claimed by taxpayers; (2) provide administrative and technical support to the Council on Revenues, assisting in the preparation of forecasts for General Fund tax revenues and total personal income; (3) provide economic and statistical analyses to help the Department execute its policies and programs; (4) prepare reports on the revenue consequences of proposed tax legislation for the Legislature, the Governor, and other agencies in the Administration; (5) conduct economic analysis and educate the Legislature, the Governor, and other State agencies regarding the state's tax system; and (6) provide administrative and technical support to the Tax Review Commission when it is in session.

The TRP Office prepares the following reports on a monthly, fiscal year, and calendar year basis:

(1) State Tax Collections and Distributions; (2) General Excise and Use Tax Collections; (3) Liquid Fuel Tax Base and Collections; (4) Liquid Fuel Tax Allocations by Fund; (5) Liquor Tax Collections and Permits; (6) Tobacco Tax Collections and Licenses, and (7) Preliminary Comparative Statement of General Fund Tax Revenues.

In fiscal year 2017, the TRP Office worked on the Department of Taxation's Annual Report: 2015–2016, which was completed and submitted in December of 2016. The Office also published reports on tax credits claimed by Hawaii taxpayers in tax year 2014 and on statistics on Hawaii's individual income tax in tax year 2014.

For the 2017 Legislative session, TRP staff reviewed and tracked tax-related legislative bills and resolutions, and prepared more than 300 revenue estimates for various drafts of the bills. Revenue estimates were also prepared for various proposals in response to requests from the Administration, legislators, and others.

An important function of the TRP Office is to provide administrative and technical support to help the Council on Revenues produce its forecasts of tax revenues. The seven members of the Council are responsible for forecasting State General Fund revenues and the State's total personal income. The Council provides forecasts of State revenue for the current and six subsequent fiscal years. The forecasts are due on September 10, January 10, March 15, and June 1 of each year. The forecasts are used by the Governor and by the Legislature to develop and administer the State's budget. The Council also forecasts total personal income (TPI) for the current and immediately following calendar years. The TPI forecasts are due on August 5 and November 5 of each year. The growth in Hawaii total personal income is used to set the ceiling for expenditures from the State's General Fund, as required by the State's Constitution.

TRP staff applied advanced econometric modeling techniques to data on State tax collections and to data on other economic variables to help the Council produce its forecasts. The Council's last General Fund forecast for fiscal year 2017 was produced on May 30, 2017. The forecast called for tax collections dedicated to the Fund to grow by 2.5% compared with fiscal year 2016. Tax collections actually grew by 2.0%. The Council's last forecast for total personal income for calendar year 2016 was produced on October 31, 2016 and called for growth of 4.5% over calendar year 2015.

The TRP Office updated its econometric models that were developed to predict General Fund tax collections based on the Council's forecasts for economic variables, including its original model, the model that was developed under a contract with UCLA Anderson Forecast, and the single-equation model that the Office developed at the request of the Council on Revenues.

The TRP officer served as the co- Executive Director of the 2015-2017 Tax Review Commission. The office provided information and research needed to support the Commission's activities, delivering several presentation and preparing a report on the State's revenue system.

#### ***2.4.4 Information Technology Services Office***

The Information Technology Services (ITS) Office is responsible for providing technical support for the Department's computerized tax systems and applications, local area network, and network-

related components and infrastructures.

During FY 2017, the ITS Office continued to focus on managing, administering, and maintaining the Integrated Tax Information Management System (ITIMS) and supporting network-related components and infrastructures. The ITS Office also supported the multi-year Tax System Modernization (TSM) Program, which will eventually replace all the Department's current information technology systems and applications.

As the department progresses through its multi-year Tax System Modernization (TSM) Program, it becomes increasingly important that its current Integrated Tax Information Management System (ITIMS) remain stable with minimal changes introduced in order to facilitate the incremental, multi-year changeover.

As defined by its charter, the TSM Program was overseen by an executive steering committee consisting of senior Department officials, including the Director of Taxation, who acted as the program executive sponsor. The TSM Program Manager directed the TSM Project Management Office (PMO) and reported to the TSM Executive Steering Committee. The TSM PMO was tasked with providing project management and information technology expertise to facilitate the implementation of new technology and business process improvements.

The management of the TSM Program complied with recommendations made by the State Auditor in 2010 and represented an unprecedented effort to leverage experienced professionals and best practice methodologies to ensure the success of the Department's modernization initiative. Managing information technology projects under a program structure allowed for coordination to obtain benefits and control not available from managing projects individually.

Key initiatives continued or accomplished during FY 2017 include the following;

- Annual Tax Law Changes
- Upgrades to the department's networking infrastructure and devices
- A \$30 million contract with FAST Enterprises, LLC for the implementation and support of hardware, software, and services continued to be executed successfully. Full funding of the awarded proposal will require \$60 million to cover the implementation and maintenance of new systems through FY2025.
  - Production support for the first of five planned rollouts began as soon as it went into operations. Aging information technology replaced as part of this rollout included scanning and mail opening equipment, interactive voice response and telephony equipment, and a system for processing electronic returns received through an interface with the IRS.
  - The second rollout of the TSM Program was successfully deployed as scheduled on August 15, 2016. This entailed the deployment of a new tax information system for General Excise; Use; Seller's Collection; County Surcharge; Rental Motor Vehicle, Tour Vehicle, and Car-Sharing Vehicle Surcharge tax types.
  - The third rollout of the TSM Program, which involved adding support for Corporate Income, Franchise, Public Service Company, and Withholding tax types to the new tax information system, was successfully deployed on August 14, 2017.

- A contract with Advantech, LLC for independent verification and validation services continued to be executed in support of the TSM Program. Under this contract, consultants conducted a site visits and published four periodic assessments. Findings confirmed that the progress of the TSM Program was within the normal range for successful implementations.

Items that will likely continue into the next reporting period include the following: 1) production support for completed TSM Program rollouts; 2) provision of technical resources to facilitate knowledge transfer in preparation for future TSM Program rollouts; 3) annual Tax Law Changes; and 4) further strengthening measures to detect and stop fraudulent refunds.

While the complete replacement of existing legacy systems under the TSM Program is scheduled for completion by mid-2019, the strategic prioritization of systems impairing the Department's performance will allow the State to realize benefits as new systems are phased in.

#### ***2.4.5 Taxpayer Advocate***

The Taxpayer Advocacy Program assists taxpayers who do not have a resolution to their tax related issue after going through normal channels. This program provided assistance to 1737 taxpayers during the Fiscal Year ending June 30, 2017.

In directly, the Taxpayer Advocate also assisted taxpayers in working to resolve systemic problems within the Department. Examples of issues addressed include processing, inter-Departmental and workflow problems which affect taxpayers.

Other accomplishments of this office included speaking, teaching and participating in tax workshops and educational outreaches to tax professionals and the general public.

#### ***2.4.6 Tax Practitioner Priority Office***

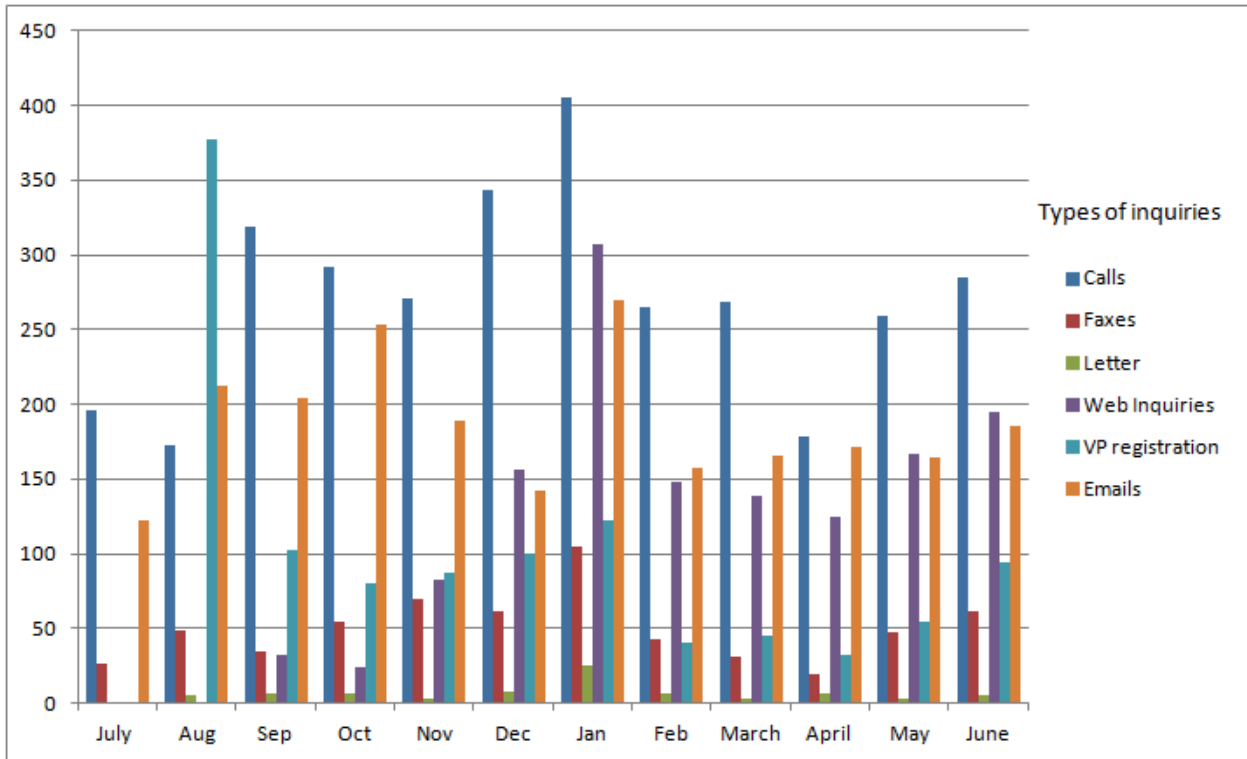
The Practitioner Priority Specialist (PPS) office provides tax practitioners a separate and dedicated connection to the Department's Taxpayer Services functions.

The PPS office has assisted 1,135 verified tax practitioners via telephone, email, and fax to resolve tax account issues such as locating and applying payments, explaining notices and letters, providing procedural guidance, and assisting with other taxpayer account inquiries. Tax issues outside these parameters were referred for follow up to the appropriate functions within the Department.

In directly, the PPS also assisted verified tax practitioners by working within the Department to improve services (including online) and workflows based on their input.

Other accomplishments of this office included speaking, teaching and participating in tax workshops and educational outreaches to tax professionals.

In fiscal year ending June of 2017, the PPS office resolved and/or referred for resolution 8,595 inquiries (see inquiry chart below):





## 2.5 MANAGEMENT PERSONNEL

As of June 30, 2017

### OFFICE OF THE DIRECTOR

Director of Taxation.....Maria E. Zielinski  
Deputy Director of Taxation.....Damien Elefante

### STAFF OFFICES

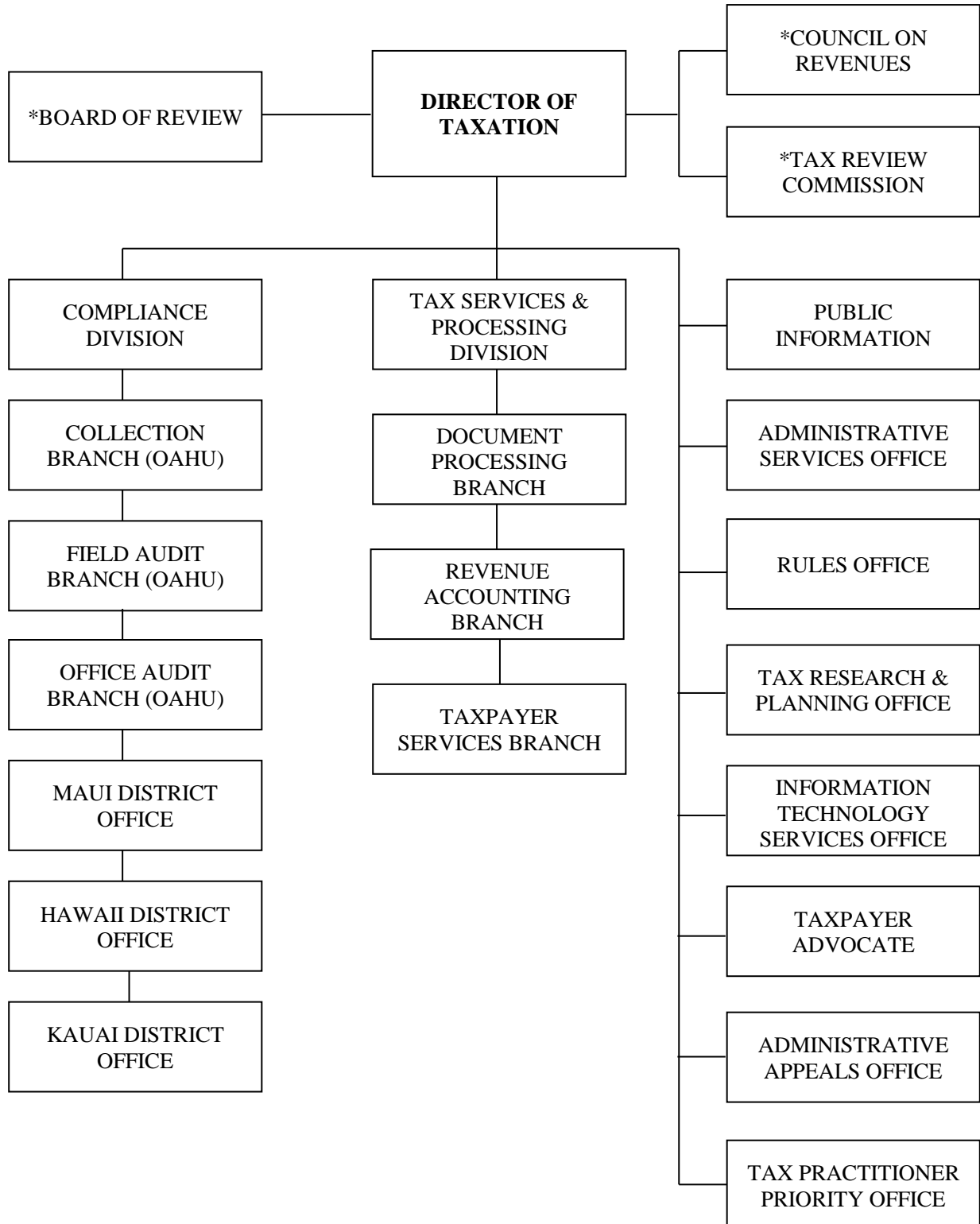
Public Information Officer .....Mallory Fujitani  
Rules Officer .....Ted Shiraishi  
    Technical Section Supervisor.....Denise Inouye  
Tax Research & Planning Officer .....Seth Colby  
    Senior Economist.....Yvonne Chow  
Information Technology Services Officer.....Robert Su  
Administrative Services Officer.....Dexter Suzuki  
    Personnel Officer .....Gene J. Dumaran  
Taxpayer Advocate .....Jaysen Y. Morikami  
Administrative Appeals Officer .....Adriane Aarona  
Tax Practitioner Priority Specialist .....Jenny Xu

### OPERATIONS STAFF

Taxation Compliance Administrator .....Kevin Wakayama  
    Tax Compliance Coordinator.....Ikaika Rawlins  
    Oahu Field Audit Branch Chief .....Madelaina Lai  
    Oahu Office Audit Branch Chief .....Donald Kuriki  
    Acting Oahu Collection Branch Chief.....Glenn Shinbo  
    Maui District Tax Manager.....Kathleen Uehara  
    Hawaii District Tax Manager.....Duquesne Hulihee  
    Kauai District Tax Manager.....Erin Tsuda  
  
Taxation Services Administrator.....Nicki Ann Thompson  
    Document Processing Operations Manager.....Todd Kuromoto  
    Revenue Accounting Branch Chief.....Jennifer Oshiro  
    Taxpayer Services Branch Chief.....John Pacheco

## 2.6 ORGANIZATION CHART

Department of Taxation  
State of Hawaii



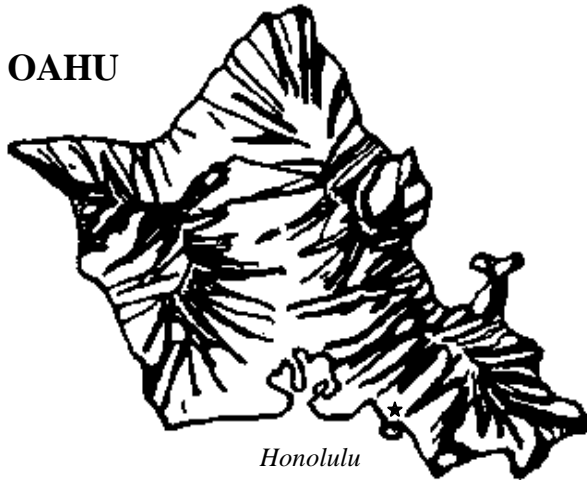
\*For Administrative Purposes.

## 2.7 DISTRICT OFFICES

### FIRST TAXATION DISTRICT

City & County of Honolulu

**OAHU**



*Honolulu*

Oahu Office  
830 Punchbowl Street  
Honolulu, Hawaii 96813

### SECOND TAXATION DISTRICT

Counties of Maui and Kalawao



*Kaunakakai*

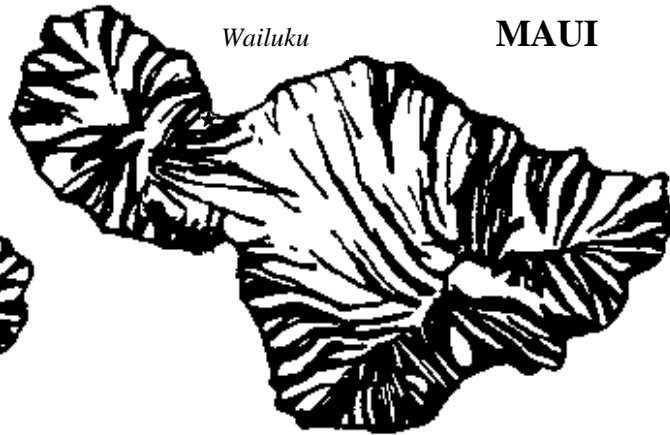
**MOLOKAI**

**LANAI**



*Wailuku*

**MAUI**



Maui Office  
54 South High Street  
Wailuku, Hawaii 96793

Molokai Office  
35 Ala Malama Street #101  
Kaunakakai, Hawaii 96748

**KAHOOLAWE**

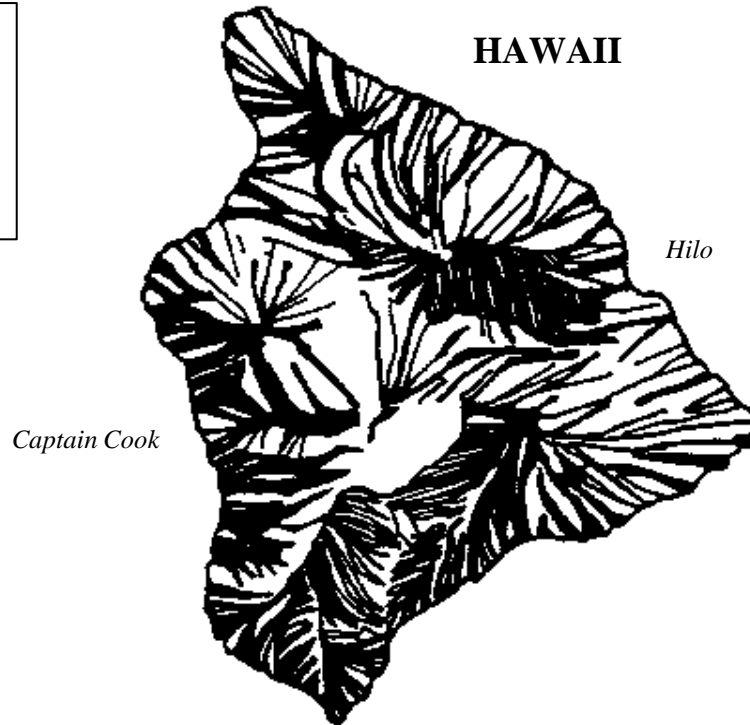


## THIRD TAXATION DISTRICT

County of Hawaii

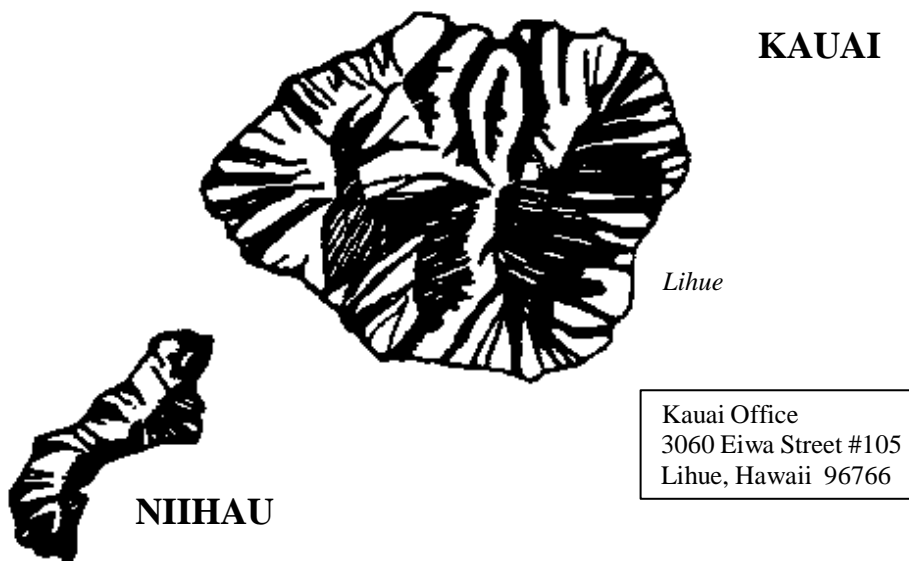
Hilo Office  
75 Aupuni Street  
Hilo, Hawaii 96720

Kona Office  
82-6130 Mamalahoa Highway #8  
Captain Cook, Hawaii 96704



## FOURTH TAXATION DISTRICT

County of Kauai



Kauai Office  
3060 Eiwa Street #105  
Lihue, Hawaii 96766

## 3.0 TAX APPEALS AND LITIGATION

### 3.1 ADMINISTRATIVE APPEALS OFFICE

The Administrative Appeals Office administers the Administrative Appeals and Dispute Resolution (AADR) program. AADR is a streamlined appeals process that assists taxpayers and return preparers in resolving their disputes involving proposed assessments, final assessments, and return preparer penalty assessments issued as a result of a DOTAX audit. Our mission is to help people resolve tax disputes fairly, expeditiously, and without litigation. The AAO is separate and independent of the Department offices that conduct audits and issue assessments.

This was a productive year for the AAO. In FY 2017, 86 appeals were filed and 62 cases closed. The AAO's caseload data is described in further detail in the table below. The AAO is working to integrate AADR into the Department's Tax System Modernization (TSM) project. Once the integration is complete, taxpayers will be able to electronically file their appeal applications with the AAO. For more information about the program, please visit our website at [tax.hawaii.gov/appeals](http://tax.hawaii.gov/appeals).

AAO Caseload for Fiscal Year 2017

Type of Case	Cases Received	Cases Closed <sup>1</sup>	Cases Pending June 30, 2017
General Excise/Use Tax	33	24	12
Income Tax	42	29	20
Other <sup>2</sup>	11	9	2
Total Cases	86	62	34

<sup>1</sup>Cases closed includes cases received in Fiscal Year 2016.

<sup>2</sup>"Other" cases involve miscellaneous tax types such as franchise tax and transient accommodations tax and cases where multiple tax types were appealed.

### 3.2 BOARDS OF TAXATION REVIEW

Each taxation district has an administrative (i.e., non-judicial) Board of Taxation Review consisting of five members. Tax disputes that are not resolved at the district tax office level may be appealed to a Board of Taxation Review unless the dispute involves the Constitution or laws of the United States. Statewide, the boards began the fiscal year with 206 pending tax appeals. During FY 2017, 27 new appeals were filed, 8 appeals withdrawn, and 29 appeals settled; a total of 196 appeals to the Boards of Taxation Review were pending at the end of the fiscal year.

The following table details appeals to the Boards of Taxation Review by taxation district:

	<u>Taxation District</u>					<u>Total</u>
	First		Second	Third	Fourth	
	Field Audit	Office Audit				
Appeals Pending (Beginning)	96	33	49	19	9	206
New Appeals	10	10	6	1	0	27
Appeals Withdrawn	4	1	2	1	0	8
Appeals Settled	11	0	11	7	0	29
Appeals Pending (Ending)	91	42	42	12	9	196

### 3.3 CIVIL DECISIONS, SETTLEMENTS AND OTHER LEGAL MATTERS

#### Matters Closed

During the last fiscal year, the Tax & Charities Division (“Division”) closed 826 Tax Department-related legal matters (excluding legislative matters in our case management system that the Department’s Legislative Division has not closed).

Appeals	-	17
Bankruptcies	-	435
Contracts	-	32
Foreclosures	-	236
Legislation (None closed yet)		
Miscellaneous	-	56
Opinions	-	23
Quiet Title	-	8
Subpoenas	-	19

#### Amounts Collected

Last fiscal year, the Division collected the following amounts<sup>5</sup>:

Tax Appeals	\$ 66,214.39
Foreclosures	\$ 357,180.01
Bankruptcies	\$ 1,160,456.10
Trusts	\$ 22,508.38
Miscellaneous	\$ 163,468.20
TOTAL:	<u>\$ 1,769,827.08</u>

<sup>5</sup> The Division also secured the dismissal of several tax appeals that would have potentially resulted in refunds to taxpayers from the General Fund and won cases on appeal that will have fiscal impact on similarly situated taxpayers and result in future tax collections that are impossible to forecast.

### ***3.2.1 Settled Cases***

#### ***Tax Appeal Court***

In the Matter of the Tax Appeal of CBIP, Inc., Case No. 09-0203, Tax Appeal Court, State of Hawaii.

Taxpayer appealed general excise tax assessments. The parties initially filed a stipulation for partial dismissal of the case. In the appeal that remained, Taxpayer argued that: (1) the assessment erroneously included general excise tax on amounts that were not gross income but, rather, were rebates of expenses; and (2) penalties were erroneous because non-filing and/or underpayment was not due to negligence or intentional disregard of rules. The parties settled the remaining claims and filed a stipulation to dismiss the case.

In the Matter of Taxpayer Appeal of Stephen A. Cipres, Case Nos. 11-1-0084, 12-1-0436, 12-1-0437, Tax Appeal Court, State of Hawaii.

Taxpayer challenged the Department's general excise tax assessments on the basis that the Department incorrectly increased his commissions for certain years and misinterpreted and misapplied the penalty provisions in the Hawaii Revised Statutes. This case was settled.

In the Matter of Charles A. Shipman, Jr., Case No. 13-1-0301, Tax Appeal Court, State of Hawaii.

Taxpayer appealed his tax assessment for general excise and transient accommodation taxes stating the assessed amounts were speculative/inflated and included improper stacking of failure to file penalties with negligence penalties. The parties agreed to dismiss this case.

Maria E. Zielinski v. Chester M. and Prudence S. Kanehira, Case No. 1 T.X. 15-1-0227

Maria E. Zielinski v. Fred M. and Shirfeir S. Sunada, Case No. 1 T.X. 15-1-0226

Maria E. Zielinski v. Dale and Alison Ohama, Case No. 1 T.X. 15-1-0231

Maria E. Zielinski v. Morris S. and Jeanne A. Creel, Case No. 1 T.X. 15-1-0232

Maria E. Zielinski v. Mark W. Baker and Lisa A. Hendrickson, Case No. 1 T.X. 15-1-0225; Tax Appeal Court, State of Hawaii;

Maria E. Zielinski v. Timothy M. and Iwalani O. Dayton, Case No. 1 T.X. 15-1-0229; Tax Appeal Court, State of Hawaii;

Maria E. Zielinski v. Predrag & Doris Miocinovic, Case No. 1 T.X. 15-1-0234; Tax Appeal Court, State of Hawaii; and

Maria E. Zielinski v. Neal S. and Linda Takase, Case No. 1 T.X. 15-1-0235; Tax Appeal Court, State of Hawaii.

In these cases, the Director of Taxation appealed decisions of the Board of Review. The Department denied Taxpayers' fully refundable Renewable Energy Technologies tax credits under Haw. Rev. Stat. § 235-12.5 because Taxpayers' adjusted gross incomes exceeded the statutory threshold entitling them to a fully refundable credit. The Board of Review ruled that Taxpayers could revoke their elections to receive refundable tax credits. These cases were settled.

In the Matter of Red Time Realty, LLC, Case No. 1 TX 15-1-0261, Tax Appeal Court, State of Hawaii.

Taxpayer appealed from a final assessment of general excise tax on gross income under Haw. Rev. Stat. §§ 237-38 and 237-39. The parties agreed to dismiss this case.

In the Matter of the Tax Appeal of New Cingular Wireless, Case No. 1 T.X. 15-1-0241, Tax Appeal Court, State of Hawaii.

Taxpayer filed refund claims for the public service tax it paid to the State. Taxpayer claimed it paid the tax on amounts not subject to the PSC. The Director denied the refund claims as they were barred by the statute of limitations. This case was settled.

In the Matter of the Tax Appeal of Andrew Bernstein and Jacqueline S. Showback, Case No. 1 T.X. 15-1-0249, Tax Appeal Court, State of Hawaii.

Taxpayers appealed from a final assessment reducing their renewable energy tax credit under Haw. Rev. Stat. § 235-12.5. This case was dismissed by stipulation.

In re Tax Appeal of Edward K. Fuller, Case No. 1 T.X. 15-1-0270, Tax Appeal Court, State of Hawaii;

In re Tax Appeal of Edward K. Fuller, Case No. 1 T.X. 15-1-310, Tax Appeal Court, State of Hawaii; and

In re Tax Appeal of Fuller Anesthesia, LLC, Case No. 1 T.X. 15-1-0309, Tax Appeal Court, State of Hawaii.

These three cases involve the same Taxpayer and his LLC, appealing general excise and income taxes for fiscal years 2006 through 2013, inclusive. The Department assessed Taxpayers after it disallowed Taxpayers' claims of the wholesale rate and certain deductions. These cases were settled.

### ***3.2.2 Closed Cases***

#### ***Tax Appeal Court***

In the Matter of the Tax Appeal of Kamaaina's Food Service, Inc., Case Nos. 12-1-0237 and 12-1-0244 (Consolidated), Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise tax and county surcharge when applicable, for unreported service income for tax years 1987 through 1992, 1994, 1995, 1997, 1998, and 2000 through 2009, inclusive, and/or imposed a 25 percent penalty for failure to file and a 25 percent penalty due to negligence or intentional disregard of rules. Taxpayer was assessed for general excise tax for unreported service income for tax years 1993, 1996, and 1999; the Department imposed a 25 percent penalty for failure to file and a 25 percent penalty due to negligence or intentional disregard of rules. Taxpayer disputed the assessments, arguing that the imposition of both penalties is not authorized by statute. The Court granted Director's motions for summary judgment.

In the Matter of the Tax Appeal of Barbara Gilliss, Case No. 12-1-0303, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise and county surcharge taxes, when applicable, for rental income in tax years 2002 through 2011, inclusive. Taxpayer argued that the penalties and interest should be waived. The Department filed a motion for summary judgment that was heard and granted on April 18, 2016.



In re Tax Appeal of David J. Scroggin and Genya G. Scroggin, Case No. 1 T.X. 15-1-0286, Tax Appeal Court, State of Hawaii.

Director prevailed on a motion to dismiss for failure to properly serve this appeal. Subsequently, after the Order granting the motion and Judgment were filed, Taxpayers filed a motion to set aside the dismissal claiming that they did not receive notice of the hearing on the Motion to Dismiss. The Taxpayers' Motion to Set Aside was denied.

In the Matter of the Tax Appeal of Steve F. Klein and Krista S. Bridges, Case No. 1 T.X. 15-1-0322, Tax Appeal Court, State of Hawaii.

Taxpayers appealed the disallowance of the Renewable Technologies Income Tax Credit under section Haw. Rev. Stat. 235-12.5 for failing to timely claim the credit. A notice of dismissal was filed.

In the Matter of the Tax Appeal of Haruki and Kayoko Higashitai, Case No. 1 T.X. 16-1-0324, Tax Appeal Court, State of Hawaii.

Taxpayer appealed income tax assessments disallowing itemized deductions for insufficient substantiation. Taxpayers also claimed that the notice of proposed assessment were not mailed to their current address and did not provide for translation services. The Court granted the Director's motion to dismiss.

### ***3.2.3 Pending Appeals***

#### ***Hawaii Supreme Court***

In the Matter of Priceline.com, SCAP No. 17-0000367, Supreme Court, State of Hawaii. (and consolidated cases).

These consolidated tax appeals are by online travel companies Priceline.com, Travelocity.com, Orbitz.com, Hotels.com ("OTCs") from assessments of general excise tax, penalties and interest for the OTCs' rental motor vehicle transactions in the State for tax years 2000 through 2013, inclusive. The Department assessed the OTCs for their "stand alone" car rentals as well as car rentals included as part of travel or tour packages. The Department and various taxpayers filed cross-appeals of the tax appeal court ruling. The parties submitted briefs to the Hawaii Supreme Court. No oral argument has been set.

Tax Foundation of the State of Hawaii, Inc. v. State of Hawaii, CAAP-16-0000462, Intermediate Court of Appeals, State of Hawaii.

In this case, the Tax Foundation of the State of Hawaii brought an action for injunctive and mandamus relief. At issue is the county surcharge on state tax, Haw. Rev. Stat. § 248-2.6, that requires the Department of Budget and Finance to transfer ten percent of the amount collected to the general fund to reimburse the Department of Taxation's costs of assessment and collection of the surcharge. Plaintiff argued that amounts transferred to the general fund exceed the Department of Taxation's actual costs and expenses. Under these facts, Plaintiff alleges that the statute violates the due process and equal protection clauses of the United States Constitution. The complaint seeks refunds on Plaintiff's behalf and on behalf of the City and County of Honolulu. The Department moved to dismiss the complaint for lack of subject matter jurisdiction. The complaint was dismissed and Plaintiff appealed to the Hawaii Supreme Court. The Hawaii Supreme Court heard oral arguments on July 6, 2017 and has not issued a ruling to date.

### ***Intermediate Court of Appeals***

In the Matter of the Tax Appeal of CompUSA Inc., CAAP No. 15-0000861, Intermediate Court of Appeals, State of Hawaii.

Taxpayer appealed from the disallowance of a use tax refund request for tax years 2006, 2007, and 2008. Taxpayer argues that under the commerce and equal protection clauses of the United States Constitution the imposition of Hawaii's use tax is unconstitutional. The Tax Appeal Court determined that the use tax is constitutional under the commerce and equal protection clauses of the United States Constitution. The issues were fully briefed and the parties are waiting for a decision from the Intermediate Court of Appeals.

### ***Tax Appeal Court***

In the Matter of the Tax Appeals of TMI Management, Inc., Case Nos. 09-0071 and 09-0072, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes on amounts received for performing work for the federal government. Taxpayer argues, among other things, that the disputed income was exempt because Taxpayer was an employee leasing company and the disputed income was for salaries and expenses of leased employees. This case has been taken off the trial ready calendar to give the parties time to work on settlement.

In the Matter of the Tax Appeals of Bernard & Ellen Fuller and South Pacific Builders, Ltd., Case Nos. 09-0087, 09-0088, and 09-0089, Tax Appeal Court, State of Hawaii.

Taxpayers were assessed additional general excise and net income taxes on amounts received for performing work within the state. Taxpayers argue, among other things, that the disputed income was exempt because Taxpayers paid certain amounts to other contractors. Trial is set for July 16, 2018.

In the Matter of Tax Appeal of James J. Richard & Rachael D. Richard, Case No. 10-1-1805, Tax Appeal Court, State of Hawaii.

Taxpayers were assessed additional income and general excise taxes. Taxpayers challenged the Department's reclassification and recalculation of its liability that was based on Taxpayers' IRC § 338(g) election on a sale of a business. The basis of Taxpayers' claim is that they made an election error on the Form 8023 and the parties to the sale intended an IRC § 338(h) (10) election instead of the IRC § 338(g) election. Taxpayers also challenge the Department's reclassification of income that changed the amount received as personal loans and/or advances from their business to wages. The case was taken off the trial ready calendar to give the parties time to work on settlement.

In the Matter of the Tax Appeal of JN Group, Inc., Case No. 10-1808, Tax Appeal Court, State of Hawaii.

Taxpayer appeals general excise assessments for tax years ending March 31, 1998 through March 31, 2006, inclusive. Taxpayer claims that the amounts assessed constituted reimbursements that were exempt under Haw. Rev. Stat. § 237-20 the assessments of penalties were erroneous because any non-filing or underpayment was not due to negligence or intentional disregard of rules; the assessments violated the due process, commerce, and/or equal protection clauses of the United States Constitution and the Constitution of the State of Hawaii. Trial is set for June 25, 2018.

In the Matter of the Tax Appeal of Patrick O'Brien, Case No. 11-1-0013, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional income taxes for unreported schedule C income from a single member LLC the Taxpayer owned. Taxpayer denies the income is taxable to him. Taxpayer's counsel has withdrawn from this case and Taxpayer is seeking new counsel. Trial is set for August 20, 2018.

In the Matter of the Tax Appeal of Security Resources, LLC, Case No. 11-1-0014; Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes for underreporting the amount of gross receipts it received. Taxpayer claims the assessments are overstated and that it is entitled to be taxed at the wholesale rate of .5 percent. Taxpayer also claims some of its sales are exempt because they were sales of tangible personal property to the federal government. Taxpayer's counsel has withdrawn from this case and Taxpayer is seeking new counsel. Trial is set for August 20, 2018.

In the Matter of the Tax Appeal of Ronald Au, Case No. 11-1-0144, Tax Appeal Court, State of Hawaii.

Taxpayer filed a petition to compel the Board of Review to prepare findings of fact and conclusions of law. The court denied the petition but granted leave to the Taxpayer to file a notice of appeal from general excise tax assessments for the period 2002 through 2005, inclusive, totaling \$175,000.00. The Tax Appeal Court granted the Department of Taxation's motion to dismiss the appeal for lack of subject matter jurisdiction by order filed February 29, 2012; however, the Court granted Taxpayer's motion for reconsideration of the dismissal. The Court has taken the State's motion for summary judgment under advisement and a trial date has been scheduled for February 26, 2018.

In the Matter of the Tax Appeal of Julie A. Dunham, Case No. 12-1-0390, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise and income taxes on non-filed returns for 1999 through 2010, inclusive. Taxpayer argues that the Department's income figures are incorrect. Trial is set for September 10, 2018.

In the Matter of the Tax Appeal of Ronald Au, Case No. 1 T.X. 12-1-0393, Tax Appeal Court, State of Hawaii.

Taxpayer appeals the Department's income tax assessments on unreported income received for tax years 2008 and 2009. Trial is set for October 11, 2017.

In the Matter of the Tax Appeal of William A. Bartenstein, Case No. 13-1-0228, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise and/or use taxes, penalties and interest on goods imported for resale. Taxpayer argues that the Department's income figures were incorrect and the stacking of the negligence and underpayment penalties was erroneous. Trial is set for March 12, 2018.

In the Matter of the Tax Appeal of Ronald Au, Case No. 1 T.X. 14-1-0216, Tax Appeal Court, State of Hawaii.

Taxpayer appeals to the Tax Appeal Court, State of Hawaii from assessments of general

excise taxes for 2009 and 2010 in the amount of \$13,114.62. The Department moved to dismiss the tax appeal because it was not timely filed and because Taxpayer failed to pay the assessment in his appeal from the Board of Review. The motion was heard on March 17, 2014 and taken under advisement. Trial is scheduled for December 11, 2017.

In the Matter of the Tax Appeal of Skydiving School, Inc., Case Nos. 1 T.X. 14-1-0217 and 1 T.X. 14-1-0218, Tax Appeal Court, State of Hawaii.

Taxpayer appeals from the denial of a refund claim and assessments of general excise taxes related to its skydiving business. Taxpayer's major issue is that its gross receipts from skydiving activities is not subject to the general excise tax because of federal preemption under the Anti-Head Tax Act, P.L. 103-272, 108 Stat. 1111, as amended, and as codified in 49 U.S.C. § 40116. Trial is set for November 27, 2017. The parties are working on an agreement to submit the matter on briefs in lieu of a trial.

In the Matter of the Tax Appeal of Edward A. Alquero, M.D., Inc., Case No. 1 T.X. 14-1-0219, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional income and general excise taxes, penalties, and interest for underreported income related to his medical practice. Taxpayer claims he is entitled to deductions for certain expenses that were disallowed by the Department. Trial is set for January 22, 2018.

In the Matter of the Tax Appeal of Avery B. Chumbley, Case No. 1 T.X. 14-1-0226, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise taxes and interest for underreported gross receipts of a non-profit organization's fund raising activities. Taxpayer was assessed personally as the president of the organization at the time. Taxpayer claims he was entitled to deductions for certain expenses that were disallowed by the Department. Trial is set for April 23, 2018.

In the Matter of the Tax Appeal of Darren Truitt, Case No. 1 T.X. 14-1-0228, Tax Appeal Court, State of Hawaii.

Taxpayer appeals the Department's assessment of additional income taxes, penalties, and interest for income attributed to his wholly-owned LLC. Trial is set for June 4, 2018.

In the Matter of the Tax Appeal of Construction Servs. & Management LLC, Case No. 1 T.X. 14-1-0229, Tax Appeal Court, State of Hawaii.

Taxpayer appeals the Department's assessment of general excise taxes, penalties, and interest for underreported gross receipts. Trial is set for June 24, 2018.

In the Matter of the Tax Appeal of Hawaiian Telcom Services Company, Inc., Case No. 1 14-1-0231, Tax Appeal Court, State of Hawaii;

In the Matter of the Tax Appeal of Hawaiian Telcom Services Company, Inc., Case No. 1 15-1-0245, Tax Appeal Court, State of Hawaii; and

In the Matter of the Tax Appeal of Hawaiian Telcom Services Company, Inc., Case No. 1 16-1-0321, Tax Appeal Court, State of Hawaii.

Taxpayer appeals the denial of use tax refund claims. Taxpayer claims that Haw. Rev. Stat. §§ 238-2 and 238-2.3 impermissibly imposes use tax in violation of the commerce clause and the equal protection clause of the United States Constitution; the statutes discriminate against interstate commerce and are not fairly apportioned; and that Taxpayer erroneously paid use taxes with respect to services and/or contracting performed within the state by a

licensed seller. Trial is not set.

In the Matter of the Tax Appeal of Hawaiian Telcom, Inc., Case No. 1 T.X. 14-1-0232, Tax Appeal Court, State of Hawaii;

In the Matter of the Tax Appeal of Hawaiian Telcom, Inc., Case No. 1 T.X. 15-1-0244, Tax Appeal Court, State of Hawaii; and

In the Matter of the Tax Appeal of Hawaiian Telcom, Inc., Case No. 1 T.X. 16-0322, Tax Appeal Court, State of Hawaii.

Taxpayer appeals the denial of use tax refund claims. Taxpayer claims that Haw. Rev. Stat. §§ 238-2 and 238-2.3 impermissibly imposes use tax in violation of the commerce clause and the equal protection clause of the United States Constitution; the statutes discriminate against interstate commerce and are not fairly apportioned; and that Taxpayer erroneously paid use taxes with respect to services and/or contracting performed within the state by a licensed seller. Trial is not set.

In the Matter of the Tax Appeal of Hawaiian Telcom Communications, Inc., Case No. 1 T.X. 16-1-0323, Tax Appeal Court, State of Hawaii.

Taxpayer appeals the denial of use tax refund claims. Taxpayer claims that Haw. Rev. Stat. §§ 238-2 and 238-2.3 impermissibly imposes use tax in violation of the commerce clause and the equal protection clause of the United States Constitution; the statutes discriminate against interstate commerce and are not fairly apportioned; and that Taxpayer erroneously paid use taxes with respect to services and/or contracting performed within the state by a licensed seller. Trial is not set.

In the Matter of the Tax Appeal of Hawaiian Electric Company, Inc., Case No. 1 T.X. 14-1-0233, Tax Appeal Court, State of Hawaii;

In the Matter of the Tax Appeal of Hawaiian Electric Company, Inc., Case No. 1 T.X. 15-1-0296, Tax Appeal Court, State of Hawaii; and

In the Matter of the Tax Appeal of Hawaiian Electric Company, Inc., Case No. 1 T.X. 16-1-0316, Tax Appeal Court, State of Hawaii.

Taxpayer appeals the denial of use tax refund claims. Taxpayer claims that Haw. Rev. Stat. §§ 238-2 and 238-2.3 impermissibly imposes use tax in violation of the commerce clause and the equal protection clause of the United States Constitution and that the statutes discriminate against interstate commerce and were not fairly apportioned. Trial is not set.

In the Matter of the Tax Appeal of BAE Systems Holdings, Inc. & Subs., Case No. 1 T.X. 14-1-0234, Tax Appeal Court, State of Hawaii.

Taxpayer's claims for the High Tech Credit provided under Haw. Rev. Stat. § 235-110 were denied because Taxpayer did not make an investment as defined by statute. Taxpayer prevailed at the Board of Review and the Department filed this appeal. Trial is set for November 19, 2018.

In the Matter of the Tax Appeal of Hawaiian Airlines, Inc., Case No. 1 T.X. 14-1-0258, Tax Appeal Court, State of Hawaii.

Taxpayer appeals the denial of use tax refund claims. Taxpayer claims that Haw. Rev. Stat. §§ 238-2 and 238-2.3 impermissibly imposes use tax in violation of the commerce clause and the equal protection clause of the United States Constitution and that the statutes discriminate against interstate commerce and are not fairly apportioned. Trial is not set.

In the Matter of the Tax Appeal of Hawaii Electric Light Company, Inc., Case No. 1 T.X. 14-1-0259, Tax Appeal Court, State of Hawaii;

In the Matter of the Tax Appeal of Hawaii Electric Light Company, Inc., Case No. 1 T.X. 15-1-0297, Tax Appeal Court, State of Hawaii; and

In the Matter of the Tax Appeal of Hawaii Electric Light Company, Inc., Case No. 1 T.X. 16-1-0317, Tax Appeal Court, State of Hawaii.

Taxpayer appeals the denial of use tax refund claims. Taxpayer claims that Haw. Rev. Stat. §§ 238-2 and 238-2.3 impermissibly imposes use tax in violation of the commerce clause and the equal protection clause of the United States Constitution and that the statutes discriminate against interstate commerce and are not fairly apportioned. Trial is not set.

In the Matter of the Tax Appeal of Maui Electric Company, Inc., Case No. 1 T.X. 14-1-260, Tax Appeal Court, State of Hawaii;

In the Matter of the Tax Appeal of Maui Electric Company, Inc., Case No. 1 T.X. 15-1-0298, Tax Appeal Court, State of Hawaii; and

In the Matter of the Tax Appeal of Maui Electric Company, Inc., Case No. 1 T.X. 16-1-0315, Tax Appeal Court, State of Hawaii.

Taxpayer appeals the denial of use tax refund claims. Taxpayer claims that Haw. Rev. Stat. §§ 238-2 and 238-2.3 impermissibly imposes use tax in violation of the commerce clause and the equal protection clause of the United States Constitution and that the statutes discriminate against interstate commerce and are not fairly apportioned. Trial is not set.

In re Tax Appeal of Longs Drug Stores Ca., LLC, Case No. 1 T.X. 14-1-0240, Tax Appeal Court, State of Hawaii;

In re Tax Appeal of Longs Drug Stores Ca., LLC, Case No. 1 T.X. 15-1-0237, Tax Appeal Court, State of Hawaii; and

In re Tax Appeal of Longs Drug Stores Ca., LLC, Case No. 1 T.X. 16-1-0314, Tax Appeal Court, State of Hawaii.

These cases are on hold pending the outcome of In the Matter of the Tax Appeal of CompUSA Inc., Case Nos. 12-1-0264, 12-1-0265, Tax Appeal Court, State of Hawaii. No trial date will be set until the Tax Appeal Court is notified of a decision in the CompUSA matter.

In the Matter of the Tax Appeal of Home Depot U.S.A., Inc., Case No. 1 T.X. 15-1-0218, Tax Appeal Court, State of Hawaii.

Taxpayer appeals the Department's disallowance of the wholesale rate on general excise taxes due on sales to customers at its retail stores as well as the Department's denial of the subcontractor deduction related to work performed for customers. Trial is set for November 19, 2018.

In the Matter of the Tax Appeal of Dan S. Tetsutani, Case No. 1 T.X. 15-1-0219, Tax Appeal Court, State of Hawaii.

Taxpayer appeals from a final assessment of additional general excise tax and/or use taxes stating the assessments were improper or in the alternative that Taxpayer should pay the wholesale rate of .5 percent. Trial is set for December 4, 2017.

Maria E. Zielinski v. Blake and Bianca Goodman, Case No. 1 T.X. 15-1-0221; Tax Appeal Court, State of Hawaii.

The Department denied Taxpayers' fully refundable Renewable Energy Technologies tax credits under Haw. Rev. Stat. § 235-12.5 because Taxpayers' adjusted gross income exceeded the statutory threshold entitling them to a fully refundable credit. The Board of Review ruled that Taxpayers could revoke their elections to receive refundable tax credits. Cross motions for summary judgment were heard on July 17, 2017 and the court has not ruled yet. Trial was taken off the trial ready calendar.

In re Tax Appeal of Escal Institute of Advanced Technologies, Inc., Case No. 1 T.X. 15-1-0276, Tax Appeal Court, State of Hawaii.

Taxpayer, for itself and its shareholders, appeals assessments on tax years 2008 and 2010 for income tax refunds denied; 2011 through 2013, inclusive, for income taxes assessed; and 2008, 2009, 2011 through 2013, inclusive, for general excise taxes assessed, alleging that refunds to shareholders were wrongly denied. Additionally, Taxpayer alleges that income taxes and general excise taxes were assessed on income from services performed outside Hawaii. Trial is scheduled for November 26, 2018.

In the Matter of Charles Mixon, Case No. 1 T.X. 15-1-0281, Tax Appeal Court, State of Hawaii.

Taxpayer appeals from a final assessment of general excise tax for underreported income under Haw. Rev. Stat. § 237-13(6)(A). Trial is set for January 8, 2018.

In re Tax Appeal of Pacific Isles Equipment Rental Inc., Case No. 1 T.X. 15-1-0315, Tax Appeal Court, State of Hawaii.

Taxpayer's President, a non-attorney, initially filed a Notice of Appeal of general excise taxes for tax years 2010, 2011, and 2012 and made payment "under protest." Taxpayer hired an attorney who filed a Complaint for Refund of Taxes in the tax appeal case. A motion to dismiss was granted in part and denied in part; the appeal survived. Taxpayer claims that pursuant to Haw. Rev. Stat. § 237-13, the 0.5 percent wholesale rate applies rather than the 4.5 percent contracting rate. Trial is not set.

In re Tax Appeal of Jeffrey Scott Lindner, Case No. 1 T.X. 16-1-0300, Tax Appeal Court, State of Hawaii.

Taxpayer appeals income taxes for tax years 2012 through 2014, inclusive. Taxpayer claims that he properly filed returns to qualify for HTBITC credits per Haw. Rev. Stat. § 235-110.9; however, the Department claims that it did not receive the returns. Trial is not set.

In re Tax Appeal of WC Maui Coast, LLC, Case No. 1 T.X. 16-1-0271, Tax Appeal Court, State of Hawaii.

Taxpayer appeals application of transient accommodations tax assessments for tax years 2012 and 2013 pursuant to Haw. Rev. Stat. § 237D-2. Taxpayer claims that amounts received from long term contracts with airlines are exempt from Transient accommodations taxes based on AG Opinion 90-6. Trial is scheduled for January 11, 2018.

In the Matter of the Tax Appeal of Polynesian Cultural Center, Case No. 1 T.X. 16-1-0290, Tax Appeal Court, State of Hawaii.

Taxpayer appeals the Department's assessment of additional general excise taxes based on the disallowance of the income splitting provisions allowed under Haw. Rev. Stat. § 237-

18(f). Trial is not set.

In re Tax Appeal of Thomas Aki, Case No. 1 T.X. 16-1-0291, Tax Appeal Court, State of Hawaii.

Taxpayer appeals income tax assessments for tax years 2012, 2013, and 2014 in which the Department disallowed business expenses and deductions under Haw. Rev. Stat. chapter 235, disallowed the personal exemption deduction, and disallowed the application of losses from prior years. Trial is not set.

In re Tax Appeal of Editha C. Doctolero, Case No. 1 T.X. 16-1-0292, Tax Appeal Court, State of Hawaii.

Taxpayer runs a wholesale flower-selling business and failed to fully pay general excise taxes on tax years 2001, 2003, and 2005 through 2013, inclusive. Taxpayer argues that the twelve-month limitation under Haw. Rev. Stat. § 237-9.3, HRS, does not apply because the wholesale rate is not a tax benefit subject to denial under Haw. Rev. Stat. § 237-9.3, but rather the regular rate of tax on wholesale sales. Trial is not set.

In the Matter of the Tax Appeal of Howard T. Chang and Jenifer M. Chang, Case No. 1 T.X. 16-1-0318, Tax Appeal Court, State of Hawaii.

Taxpayers appeal final assessments of income taxes based on gambling winnings without offset of gambling losses. Trial is not set.

In the Matter of the Tax Appeal of Gary Takahashi Sports Marketing Inc., Case No. 1 T.X. 16-1-0319, Tax Appeal Court, State of Hawaii.

Taxpayer appeals final assessments of general excise tax based on information obtained from the Internal Revenue Service. Taxpayer claims that assessments were improper because all sales occurred outside of Hawaii. Trial is not set.

In the Matter of the Tax Appeal of Gary K. Takahashi, Case No. 1 T.X. 16-1-0320, Tax Appeal Court, State of Hawaii.

Taxpayer appeals final assessments of general excise tax based on information obtained from the Internal Revenue Service. Taxpayer claims that the assessments should have been made on Gary Takahashi Sports Marketing Inc. and not on him individually. Trial is not set.

In the Matter of the Tax Appeal of Fung Yang, Case No. 1 T.X. 16-1-0325, Tax Appeal Court, State of Hawaii.

Taxpayer claims the solar credit for a photovoltaic system used to operate chillers for his farming operation. The Department disallowed the credit because (1) the credit was improperly claimed for equipment not related to the photovoltaic system; and (2) it was not clear that the system was installed for nonresidential use. Trial is not set.

In the Matter of the Tax Appeal of Woodley L. Hunt; Gayle G. Hunt; Hunt ELP, Ltd.; Hunt Companies, Inc.; HB GP, LLC; Marion L. Hunt; and Norma H. Hunt, Case No. 1 T.X. 16-1-0340, Tax Appeal Court, State of Hawaii.

Taxpayers appeal income tax assessments for underreported taxable income due to understatement of partnership's capital gains received from sale of real property in Hawaii. Taxpayers argue that the capital gains in question should be excluded from the Hawaii sales factor numerator and denominator for apportionment purposes. Trial is not set.



In the Matter of the Tax Appeal of Amerisourcebergen Drug Corporation, Case Nos. 1 T.X. 17-1-0218 -1 T.X. 17-1-0222, Tax Appeal Court, State of Hawaii.

Taxpayer sold drugs to non-profit hospitals for resale and paid general excise tax on the transactions at the wholesale rate. The Department assessed Taxpayer at the retail rate because the non-profit hospitals did not pay four percent on their retail sales of the drugs. Trial is not set.

In the Matter of the Tax Appeal of Janice P.C. Hori, Case No. 1 T.X. 17-1-1340, Tax Appeal Court, State of Hawaii.

Taxpayer appeals final assessments of general excise taxes that were made based on information obtained from Taxpayer's income tax return. Taxpayer did not file general excise tax returns for years listed on her income tax return. Trial is not set.

In the Matter of the Tax Appeal of Certified Erosion Control Hawaii LLC., Case No. 1 T.X. 17-1-1341, Tax Appeal Court, State of Hawaii.

Taxpayer appeals final assessments of general excise tax claiming it was entitled to the wholesale rate. Taxpayer was a non-filer and submitted unfiled returns with the auditor during the audit phase. Although Taxpayer qualified for the wholesale rate, the rate was disallowed because of Act 155. Trial is not set.

In the Matter of the Tax Appeal of Robert E. Atkinson, MD, Inc., Case No. 1 T.X. 17-1342, Tax Appeal Court, State of Hawaii.

Taxpayer appeals final assessments of general excise tax of partnership payments. Trial is not set.

In the Matter of the Tax Appeal of SMB I LLC, Case No. 1 T.X. 17-1-1343, Tax Appeal Court, State of Hawaii.

Taxpayer appeals final assessments for the disallowance of the renewable energy technologies income tax credit and the capital goods excise tax credit because the credits were not properly claimed under Haw. Rev. Stat. §§ 235-12.5 and 235-110.7. The Department's Administrative Appeals Office is presently handling this case. Trial is not set.

In the Matter of the Tax Appeal of Samuel Fujikawa, Case No. 1 T.X. 17-1-1344, Tax Appeal Court, State of Hawaii.

Taxpayers appeal final assessments for the disallowance of the renewable energy technologies income tax credit and the capital goods excise tax credit because the credits were not properly claimed under Haw. Rev. Stat. §§ 235-12.5 and 235-110.7. The Department's Administrative Appeals Office is presently handling this case. Trial is not set.

In the Matter of the Tax Appeal of Robert and Kimberli Fujikawa, Case No. 1 T.X. 17-1-1345, Tax Appeal Court, State of Hawaii.

Taxpayers appeal final assessments for the disallowance of renewable energy technologies income tax credit and the capital goods excise tax credit because the credits were not properly claimed under Haw. Rev. Stat. §§ 235-12.5 and 235-110.7. The Department's Administrative Appeals Office is presently handling this case. Trial is not set.

In the Matter of the Tax Appeal Marc Unowitz and Ann Unowitz, Case No. 1 T.X. 17-1-1346, Tax Appeal Court, State of Hawaii.

Taxpayers appeal final assessments for the disallowance of the renewable energy technologies income tax credit and the capital goods excise tax credit because the credits were not properly claimed under Haw. Rev. Stat. §§ 235-12.5 and 235-110.7. The Department's Administrative Appeals Office is presently handling this case. Trial is not set.

In the Matter of the Tax Appeal of Steven J. Bookatz and Debra S. Bookatz, Case No. 1 T.X. 17-1347, Tax Appeal Court, State of Hawaii.

Taxpayers appeal final assessments of income based on gambling winnings that were not off set by itemized deductions due to the cap set forth in Act 97, Session Laws of Hawaii 2011. Trial is not set.

In the Matter of the Tax Appeal of Michelle Richardson, Case No. 1 T.X. 17-1-1349, Tax Appeal Court, State of Hawaii.

Taxpayer appeals final assessments of income and general excise taxes that were based on federal data because Taxpayer is a non-filer. Trial is not set.

In the Matter of the Tax Appeal of Hawaii & Lighting Rentals, Inc., Case No. 1 T.X. 17-1350, Tax Appeal Court, State of Hawaii.

Taxpayer appeals final assessment of general excise taxes/use tax claiming it was entitled to wholesale rate. Taxpayer would have qualified for wholesale rate but audit revealed that Taxpayers customers either did not have a general excise license or did not file returns. Trial is not set.

In the Matter of the Tax Appeal of Maui Fresh Fish Investors, LLC, Case No. 1 T.X. 17-1361, Tax Appeal Court, State of Hawaii.

Taxpayer appeals a Board of Review's decision that agreed with the Director who disallowed credits that Taxpayer claimed for its investment in a Qualified High Technology Business. Trial is not set.

In the Matter of the Tax Appeal of Saturn Development I, LLC fka PDC I, Inc., Case No. 1 T.X. 17-1-1362, Tax Appeal Court, State of Hawaii;

In the Matter of the Tax Appeal of Saturn Development, LLC fka Property Development Centers, LLC, Case No. 1 T.X. 17-1-1363, Tax Appeal Court, State of Hawaii.

In these cases, Taxpayers appeal the denial of its conveyance tax refund claim. Taxpayers allege that it entered into a tentative agreement to sell properties, some of which were still under construction. It is claimed that the parties' tentative purchase price reflected anticipated construction costs, and that this estimated purchase price was used in the original Conveyance Tax Certificate and was subject to adjustment. Taxpayers later filed an amended Conveyance Tax Certificate claiming the actual sales prices for some of the parcels were lower than estimated and requested refunds for the overpayment of conveyance tax, which the Department denied. Trial is not set.

In the Matter of the Tax Appeal of Escal Institute of Advanced Technologies, Inc., Case No. 1 T.X. 17-1-1374, Tax Appeal Court, State of Hawaii.

Taxpayer, for itself and its shareholders, appeals assessments on tax years 2012 and 2013 for income tax refunds denied, alleging that refunds to shareholders were denied.

Additionally, Taxpayer alleges that income taxes and general excise taxes were assessed on income from services performed outside Hawaii. Trial is not set.

### ***3.2.4 Criminal Investigations/Enforcement Actions***

During FYE 2017, the Criminal Investigation Section (CIS) achieved substantial outcomes in pursuing its investigative priorities. CIS conducted forty-two (42) investigations on entities with legitimate sources of income and on individuals and criminal groups involved in illegal activities, such as narcotics trafficking, gambling, prostitution, and other financial fraud. CIS conducted one additional investigation relating to threats made against DOTAX employees.

CIS continues to work with the United States Attorney's Office for review and federal prosecution of its investigations. During FYE 2017, one fraudulent refund case was adjudicated with the defendant sentenced to twenty four (24) months imprisonment and \$241,897 in restitution. The United States Attorney's Office also charged two tax preparer cases during this period.

CIS also actively works with County Prosecutors. During FYE 2017, the Hawaii County Prosecutor's Office adjudicated a case involving a property management company with a conviction for one count of Theft in the First Degree, ten counts of failure to file tax returns relating to General Excise Taxes and Transient Accommodation Taxes and two counts of failure to collect and pay over taxes. The defendant was ordered to serve six months imprisonment with four years of probation and to pay restitution in the amount of \$138,960 to her victims. The Honolulu Prosecutor's Office adjudicated a case with a guilty plea to six counts of tax evasion. The defendant was granted a deferral for a period of five years and was ordered to pay restitution in the amount of \$16,919.

During FYE 2017, CIS referred five cases to the Attorney General's Office for prosecution. Two of the five cases are pending plea agreements and the remaining cases are pending further action. One prosecution related to a local businessman with nine separate business entities who made unsolicited admissions after the fact and filed General Excise Tax Returns with payments.

The other pending plea arrangement relates to a tax preparation firm. One tax protester case is pending trial. CIS further concluded a prior FYE 2016 criminal case with a civil settlement of over \$175,000.

CIS is currently investigating other tax preparers covering all of the islands. These cases will be referred to the Attorney General's Office upon completion. CIS continues to pursue investigations on mainland companies doing business in the State of Hawaii and on individuals and criminal groups involved in illegal activities.

Completed investigations that were not referred for criminal prosecution were turned over to the appropriate Oahu Office Audit Branch, Field Audit Branch or Outer Island District Offices for further civil examination. Over four hundred referrals were made for civil assessments. For FYE 2017, these referrals amounted to over \$984,976 in additional assessments. These assessments were mutually exclusive to those made for prior-year adjudicated criminal cases.

During FYE 2017, the Criminal Investigation Section continued to promote voluntary compliance through the aggressive enforcement of Hawaii Tax Laws and Regulations. CIS contributed

\$872,380 in criminal collections in FYE 2017. The Criminal Investigation Section continues to innovate its investigative approach and to strive to improve its processes for the Department of Taxation.

## **ADMINISTRATIVELY ATTACHED ENTITIES**

As of June 30, 2017

### **COUNCIL ON REVENUES**

Kurt Kawafuchi, Chair  
Marilyn M. Niwao, Vice-Chair  
Carl S. Bonham  
Ed. Case  
Christopher Grandy  
Kristi L. Maynard  
Jack P. Suyderhoud

### **TAX REVIEW COMMISSION**

Colleen M. Takamura, Chair  
Vaughn G. T. Cook, Vice Chair  
Raymond N. Blouin  
M. Nalani Fujimori Kaina  
John M. Knox  
Dawn Lippert  
William (Billy) Pieper II

### **BOARDS OF TAXATION REVIEW**

#### ***FIRST TAXATION DISTRICT (OAHU)***

Eric Ching  
Neil Hirasuna  
Curtis Saiki  
Vacant  
Vacant

#### ***SECOND TAXATION DISTRICT (MAUI)***

Alan Bernaldo  
William Curtis  
Richard Drayson  
Patrick Ing  
Vacant

#### ***THIRD TAXATION DISTRICT (HAWAII)***

Marilyn Gagen  
Christopher Hannigan  
Valerie Peralto  
Richard Rovelstad  
Vacant

#### ***FOURTH TAXATION DISTRICT (KAUAI)***

Vacant  
Vacant  
Vacant  
Vacant  
Vacant